CLIENT UPDATE

CFTC CROSS-BORDER GUIDANCE, TEMPORARY EXEMPTIVE ORDER AND NO-ACTION LETTERS

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On July 15, 2013, the Commodity Futures Trading Commission (the "CFTC") issued final interpretive guidance and a policy statement (the "Final Guidance")[1] regarding the cross-border application of swaps provisions of the Commodity Exchange Act (the "CEA"), as added by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The Final Guidance finalizes the CFTC's proposed interpretive guidance and policy statement (the "Proposed Guidance")[2] published on July 12, 2012 and the proposed further guidance (the "Further Proposed Guidance")[3] published on December 21, 2012, with certain modifications and clarifications to address public comments. The Final Guidance will become effective immediately upon publication in the Federal Register.

The Final Guidance addresses: (1) the scope of the term "U.S. person"; (2) the framework for swap dealer ("SD") and major swap participant ("MSP") registration determinations; (3) the scope of the

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1 The Final Guidance and the Exemptive Order are available at http://www.cftc.gov/PressRoom/Events/opaevent_cftcstaff071213

2 *See* our client memorandum, "CFTC Issues Proposed Guidance on the Cross-Border Application of the Commodity Exchange Act to Swap Transactions," http://www.debevoise.com/newseventspubs/publications/detail.aspx?id=fd521022-999e-414b-a384-bc17a2190a63

3 *See* our client memorandum, "Further Guidance and Order with Respect to Cross-Border Application of CFTC Swap Regulation," http://www.debevoise.com/newseventspubs/publications/detail.aspx?id=00a2b8f5-fb53-40da-a078-2803de8e39d1

term "foreign branch" of a U.S. bank and the treatment of swaps involving such branches; (4) the categorization of Title VII requirements as either "Entity-Level Requirements" or "Transaction-Level Requirements"; (5) "substituted compliance" determinations; (6) the application of Entity-Level or Transaction Level Requirements to SDs and MSPs; and (7) the application of the Title VII swaps provisions where neither party to a swap is an SD or an MSP.

Additionally, in order to facilitate an orderly transition to the new swaps regime mandated by Title VII of the Dodd-Frank Act, on July 12, 2013, the CFTC published an exemptive order (the "Exemptive Order") granting temporary relief from certain swap regulations to non-U.S. SDs and MSPs and to foreign branches of U.S. SDs and MSPs, effective upon the expiration of a previous cross-border exemptive order issued on January 7, 2013 (the "January Order").[4] Since the January Order expired on July 12, 2013 and was not extended, the Exemptive Order is effective as of January 13, 2013. The Exemptive Order expires on December 21, 2013 or on such earlier date specified below.

The CFTC is seeking public comment on any issues that are not fully addressed by the Exemptive Order. The comment period lasts 30 days and ends on August 11, 2013.

Also, on July 11, 2013, the CFTC issued four no-action letters addressing certain issues relating to swaps regulation, following the announcement by European Commissioner Michael Barnier and CFTC Chairman Gary Gensler of a common "Path Forward" regarding their joint understandings on a package of measures for how to approach cross-border derivatives.

FINAL CROSS-BORDER GUIDANCE

Background and Scope of Guidance

Section 722(d) of the Dodd-Frank Act added section 2(i) of the CEA, which provides that the swap provisions of Title VII apply to cross-border activities when such activities have a "direct and significant connection with activities in, or effect on, commerce of the United States" or when they contravene CFTC rules or regulations aimed at preventing evasion of Title VII.

In the Final Guidance, the CFTC construes section 2(i) of the CEA to apply the swaps provisions of Title VII to activities outside the United States that have either:

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4 *See* footnote 3 above.

- a direct and significant effect on U.S. commerce, or
- a direct and significant connection with activities in U.S. commerce, and through such connection present the type of risks to the U.S. financial system and markets that Title VII was intended to address.

The CFTC interprets the term "direct" so as to require "a reasonably proximate causal nexus" and not to require foreseeability, substantiality or immediacy. The CFTC declined to require a transaction-by-transaction determination of whether a swap has such an effect on U.S. commerce; instead, the CFTC will assess the extent to which particular swaps activities, viewed as a class or in the aggregate, are connected to activities in U.S. commerce.

SEC Proposal

The Securities and Exchange Commission (the "SEC") recently published its own proposed rules and interpretive guidance[5] on the application of the provisions of the Securities Exchange Act of 1934 (the "Exchange Act") added by Title VII relating to cross-border security-based swap activities. In the Final Guidance, the CFTC states that it has taken the SEC's proposed guidance into account in adopting the Final Guidance; however, the CFTC notes that, unlike the SEC, which believes Congress intended the territorial application of Title VII to security-based swaps to follow similar principals to those applicable to securities under the Exchange Act, the CFTC believes Congress mandated a new regulatory regime for swaps.

Unlike the SEC's proposed rules, which state when particular requirements apply to particular situations, the Final Guidance is a statement of the CFTC's general policy regarding cross-border swap activities and allows for flexibility in its application, including consideration of all relevant facts and circumstances that are not explicitly discussed in the Final Guidance.

"U.S. Person" Definition

Generally

The Final Guidance provides that the CFTC will interpret the term "U.S. person" generally to include, but not be limited to:

- any natural person who is a resident of the United States;

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[5] *See* our client memorandum, "SEC Proposed Cross-Border Rules and Guidance on Security-Based Swap Activities," http://www.debevoise.com/newseventspubs/publications/detail.aspx?id=63d2d3a2-da28-43ad-bc3d-d9ba7b99ec2e

- any estate of a decedent who was a U.S. resident at the time of death;[6]
- 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 (other than a "U.S. Pension Plan" or a "U.S. Trust," each as defined below) (a "Specified Legal Entity"), in each case that is organized or incorporated under the laws of a state or other jurisdiction in the United States or having its principal place of business in the United States;
- any pension plan for the employees, officers or principals of a Specified Legal Entity, unless the plan is primarily for foreign employees of such entity (a "U.S. Pension Plan");[7]
- any trust governed by the laws of a state or other jurisdiction in the United States, if a court within the United States is able to exercise primary supervision over its administration;[8]
- any commodity pool, pooled account, investment fund or other collective investment vehicle that is not a Specified Legal Entity and that is majority-owned by one or more persons described above (a "U.S. Collective Investment Vehicle"), except any such entity that is publicly offered[9] only to non-U.S. persons and not offered to U.S. persons;
- any Specified Legal Entity (other than a limited liability company, limited liability partnership or similar entity where all the owners have limited liability) that is directly or indirectly majority-owned by one or more persons described above (other than a U.S. Collective Investment Vehicle) and in which such person(s) bear unlimited responsibility for the obligations and liabilities of the entity; and
- any individual account or joint account (discretionary or not) where the beneficial owner (or one of the beneficial owners in the case of a joint account) is a U.S. person as described above.

The CFTC will consider not only a person's legal form and its domicile (or location of operation), but also the economic reality of a particular structure or arrangement, along

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6 This prong was not included in the Proposed Guidance; however, it is consistent with the January Order. The Proposed Guidance instead included a prong for "an estate or trust, the income of which is subject to U.S. income tax regardless of source."

7 This prong differs from the prong in the Proposed Guidance, which referred to a pension plan for the employees, officers or principals of a legal entity with its principal place of business in the United States. However, this prong is consistent with the January Order.

8 This prong was not included in the Proposed Guidance; however, it is consistent with the January Order.

9 The CFTC revised this prong to exclude non-U.S. publicly-offered, as opposed to publicly-traded, collective investment vehicles. The Further Proposed Guidance had excluded only publicly-traded vehicles.

with all other relevant facts and circumstances, in order to identify those persons whose activities meet the "direct and significant" jurisdictional nexus and are therefore properly deemed U.S. persons.

Except as otherwise stated, the U.S. person definition in the Final Guidance is generally consistent with the definitions in the Proposed Guidance, the Further Proposed Guidance and the January Order.

Specified Legal Entity Prong

The Specified Legal Entity prong of the U.S. person definition is generally consistent with the CFTC's Proposed Guidance, the Further Proposed Guidance and the January Order. The CFTC clarifies in the Final Guidance that it expects that the Specified Legal Entity prong will include legal entities that engage in non-profit activities, as well as U.S. state, county and local governments and their agencies and instrumentalities. The CFTC also notes that it intends for this definition to include entities organized outside the United States but with the center of direction, control and coordination of their business activities in the United States.

The CFTC indicates that the "principal place of business" of a corporation is the place where the corporation's officers direct, control and coordinate the corporation's activities, which will normally be the place where the corporation maintains its headquarters (or "nerve center") as long as the headquarters is the actual center of direction, control and coordination of the entity's activities (and not simply an office where a corporation holds its board meetings).

Similarly, for a collective investment vehicle, the CFTC states that the location(s) where the entity has its registered offices, holds board meetings or maintains books and records are generally not relevant for purposes of the "U.S. person" determination; rather, it should depend on the location of the "nerve center" of the vehicle, which is its "actual center of direction, control and coordination". Therefore, the CFTC will generally consider the principal place of business of a collective investment vehicle to be in the United States if the senior personnel responsible for either (1) the formation of the vehicle (*i.e.*, the promoters)[10] or (2) the implementation of the vehicle's investment strategy[11] are located in

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[10] The location of the promoters of a collective investment vehicle is particularly relevant where the vehicle has a specialized structure or where the promoters continue to be integral to the ongoing success of the fund, including by retaining overall control of the fund.

[11] Depending on the vehicle's investment strategy, the relevant senior personnel may be those responsible for investment selections, risk management decisions, portfolio management and/or trade execution.

the United States, depending on the facts and circumstances.[12]

The CFTC also clarifies that where an individual, institution, pension plan or operating company is not otherwise within any prong of the U.S. person definition, such person would not come within the U.S. person definition solely because it retains an asset management firm located in the United States to manage its assets or provide other financial services.

The "Unlimited Responsibility" Prong

The U.S. person definition in the Final Guidance includes Specified Legal Entities (other than certain limited liability entities) that are majority-owned by a U.S. person or persons (other than a U.S. Commodity Pool) bearing unlimited responsibility for the entity's obligations and liabilities. While the Further Proposed Guidance included an almost identical prong (and the Proposed Guidance included a broader class of Specified Legal Entities 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), the January Order did not include any such prong.

The CFTC declined to limit this prong to entities that are majority-owned by U.S. person(s) bearing unlimited responsibility for "all of" the obligations and liabilities of the entity, noting that even if there are some potential obligations and liabilities that may not flow to the U.S. person(s), the risk of unlimited responsibility for other obligations and liabilities would be sufficient. Similarly, it is generally not necessary for all the U.S. persons who are majority owners to bear unlimited responsibility; it is sufficient if one owner bears such responsibility.

The CFTC clarifies that it does not intend for this prong to cover Specified Legal Entities organized or domiciled in a foreign jurisdiction whose swaps are guaranteed by a U.S. person.

The Collective Investment Vehicle Prong

The Final Guidance includes a prong for a collective investment vehicle that is not a Specified Legal Entity and that is majority-owned by one or more U.S. persons, except any vehicle that is publicly offered only to non-U.S. persons and not offered to U.S. persons. For purposes of this prong, "majority-owned" means the beneficial ownership of more than 50% of the equity or voting interests in the vehicle.

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[12] The Final Guidance provides several hypotheticals illustrating the CFTC's approach to determining the location of a collective investment vehicle's "principal place of business."

While the Proposed Guidance and the Further Proposed Guidance included collective investment vehicles that are "directly or indirectly" majority-owned by one or more U.S. persons (other than publicly traded entities that are not offered to U.S. persons), the January Order did not include such a prong.

In order to avoid practical difficulties of determining whether an entity is indirectly majority-owned by a U.S. person, the CFTC eliminated the reference to direct or indirect majority ownership by U.S. persons in the Final Guidance. Therefore, a collective investment vehicle need only determine whether its direct beneficial owners are U.S. persons and then "look through" the beneficial ownership of any other legal entity invested in it that is controlled by or under common control with such investee entity. Where a collective investment vehicle is owned in part by an unrelated investor collective investment vehicle, it need not "look through" the unrelated investor entity, but may reasonably rely upon written, bona fide representations from such entity regarding whether it is a U.S. person, unless it has reason to believe that such investor entity was formed or is operated principally for the purpose of avoiding looking through to the ultimate beneficial owners of that entity.

Unlike the Proposed Guidance, the Final Guidance does not include a prong for collective investment vehicles operated by persons required to register with the CFTC as a commodity pool operator.

Miscellaneous Clarifications

The Final Guidance provides the following additional clarifications regarding the U.S. person definition:

- A party may reasonably rely on its counterparty's written representations in determining whether the counterparty is a U.S. person. In order to rely on such representations, the party must conduct reasonable due diligence on its counterparty.
- A foreign branch of a U.S. person is a U.S. person since the branch does not have a legal identity separate from that of its principal entity.
- There may be situations where a person not fully described above is appropriately treated as a U.S. person in view of the relevant facts and circumstances and a balancing of the various regulatory interests at stake. In these circumstances, the CFTC anticipates that the relevant facts and circumstances may include: (1) the strength of the connections between the person's swap-related activities and U.S. commerce; (2) the extent to which such activities are conducted in the United States; (3) the importance to the United States (as compared to other relevant jurisdictions) of

regulating the person's swap-related activities; (4) the likelihood that including the person within the U.S. person definition could lead to regulatory conflicts; (5) considerations of international comity; and (6) how the person is currently regulated and whether such regulation encompasses the person's swap activities as they relate to U.S. commerce.

- The CFTC explicitly confirms that the Final Guidance is only applicable to interpretation of "U.S. person" for the purposes of the swaps regulations and does not address how the term "U.S. person" should be interpreted for other purposes of the CEA or CFTC regulations.

Registration

Background

The CFTC has adopted final rules (the "Final Entity Definitions Rules") and interpretive guidance implementing the statutory definitions of the terms "swap dealer" and "major swap participant" in sections 1a(49) and 1a(33) of the CEA.[13]

Regulation 1.3(ggg)(4) sets forth *de minimis* thresholds of swap dealing which take into account the notional amount of a person's swap dealing activity over the prior 12 months. When a person's swap dealing activities (together with those of its affiliates controlling, controlled by or under common control with such person) over the relevant 12-month period exceed the applicable threshold, the person must register as an SD within two months after the end of the first month in which it exceeds the threshold.

Regulation 1.3(ggg)(4) requires that a person include, in determining whether its swap dealing activities exceed the *de minimis* threshold, the aggregate notional value of swap dealing transactions entered into by any entity controlling, controlled by or under common control with such person (the "SD Aggregation Requirement").

Regulations 1.3(jjj)(1) and 1.3(lll)(1) set forth swap position thresholds for the "major swap participant" definition in Regulation 1.3(hhh). When a person holds swap positions above those thresholds, such person must register within two months after the end of the fiscal quarter in which it exceeded the relevant threshold.

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[13] *See* our client memorandum, "CFTC and SEC Release Joint Final Rule on Key Entity Definitions in Title VII of the Dodd-Frank Act," http://www.debevoise.com/newseventspubs/publications/detail.aspx?id=4ed74ee3-8bb2-4efc-9236-b6affd903e98

Swap Dealer Registration

The Final Guidance provides that the following persons should count all of their swap dealing activity with U.S. and non-U.S. counterparties in determining whether they are required to register as an SD:

- a U.S. person; and
- a non-U.S. person that is an affiliate of a U.S. person and that is guaranteed[14] by a U.S. person (a "guaranteed affiliate") or that is an "affiliate conduit" (as defined below) of a U.S. person.

A non-U.S. person that is neither a guaranteed affiliate nor an affiliate conduit should count only its swap dealing transactions with (1) U.S. persons (other than a foreign branches of U.S. SDs) and (2) guaranteed affiliates, subject to the following exceptions:

- a guaranteed affiliate that is an SD;
- a guaranteed affiliate that engages in *de minimis* swap dealing activity and is affiliated with an SD; and
- a guaranteed affiliate that is, or is guaranteed by, a non-financial entity[15].

A non-U.S. person that is neither a guaranteed affiliate nor an affiliate conduit need not count its swaps with affiliate conduits or with any other non-U.S. person that is not a guaranteed affiliate of a U.S. person, including a non-U.S. SD.

Additionally, to limit potential constraints on hedging activities, the Final Guidance also provides that swaps between a foreign branch of a U.S. SD and dealing non-U.S. persons will generally be excluded from the SD registration determination.

The Final Guidance also provides that a non-U.S. person that is not guaranteed by a U.S. person generally need not include any swap that is executed anonymously on a registered designated contract market ("DCM"), swap execution facility ("SEF") or foreign board of trade ("FBOT") and is cleared, since the non-U.S. person will have no information regarding the swap counterparty prior to execution.

With respect to the SD Aggregation Requirement, the Final Guidance interprets this requirement in a manner that applies the same aggregation principles to all affiliates in a

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14 For purposes of the Final Guidance, the term "guarantee" includes not only traditional guarantees of payment or performance of the related swaps, but also other formal arrangements that, under the facts and circumstances, support the non-U.S. person's ability to pay or perform its swap obligations.

15 The term "financial entity" is defined in section 2(h)(7)(C) of the CEA.

corporate group, whether they are U.S. or non-U.S. persons. The CFTC's policy is to apply the aggregation principle such that, in considering whether a person's swap dealing activities exceeds the *de minimis* threshold, a person (whether U.S. or non-U.S.) should generally include all relevant dealing swaps of all of its U.S. and non-U.S. affiliates under common control, except that swaps of an affiliate (either U.S. or non-U.S.) that is a registered SD are excluded. When an affiliated group meets the *de minimis* threshold in the aggregate, one or more affiliates (inside or outside the United States) would need to register as an SD so that the relevant swap dealing activity of the unregistered affiliates, in the aggregate, remains below the threshold.

Major Swap Participant Registration

The Final Guidance provides that the following persons should count the following swap positions in determining whether they are required to register as an MSP:

- A U.S. person should include all of its swap positions with U.S. or non-U.S. persons; and
- A non-U.S. person that is a guaranteed affiliate or an affiliate conduit should include, and attribute to the U.S. guarantor: (1) all of its swap positions with U.S. or non-U.S. counterparties and (2) any swaps between another person (whether U.S. or non-U.S.) and a U.S. person or guaranteed affiliate, if the potential non-U.S. MSP guarantees[16] the obligations of the other person thereunder.

A non-U.S. person that is not a guaranteed affiliate or an affiliate conduit should include the same swaps as a guaranteed affiliate or affiliate conduit, except that, among other exclusions listed below, it need not include all of its swap positions with non-U.S. counterparties; rather, it need only include its swaps positions with guaranteed affiliates that are not SDs, subject to certain conditions.

Specifically, a non-U.S. person that is not a guaranteed affiliate of a U.S. person and is a financial entity (as defined in section 2(h)(7)(C) of the CEA) generally does not need to count its exposure under swaps with (1) foreign branches of a U.S. SD or (2) guaranteed affiliates that are SDs, provided that the swap is either cleared or the documentation of the swap requires the foreign branch or guaranteed affiliate to collect daily variation margin on its swaps with such non-U.S. person. Such swaps positions must be addressed in the risk management programs of the foreign branch or guaranteed affiliate and must account

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[16] The CFTC declined to limit this interpretation to certain types of guarantees (*e.g.*, "full recourse" guarantees or guarantees under which there is a material likelihood of liability), noting that even partial recourse guarantees are an "integral part" of a guaranteed swap.

for, among other things, overall credit exposures to non-U.S. persons. A non-U.S. person's swaps with a guaranteed affiliate that is an SD must be attributed to the U.S. guarantor for purposes of determining whether its exposures are systemically-important on a portfolio basis and therefore require MSP registration.

Additionally, a non-U.S. person that is not a guaranteed affiliate and is not a financial entity generally need not count its exposure under swaps with a foreign branch of an SD or a guaranteed affiliate that is an SD.

Regarding the aggregation of swaps positions of affiliates for purposes of MSP registration, the Final Guidance provides that, where there is no guarantee or recourse to another person under the swap, the swap should generally be attributed to the person who enters into the swap, and there should be no aggregation of such swaps position(s) with those of its affiliates. However, where the counterparty to a swap has recourse to another person, such as a parent guarantor, the swap should generally be attributed to the person to whom there is recourse. Thus, if a U.S. person enters into a swap guaranteed by a non-U.S. person, the swap should generally be attributed to the non-U.S. person, and vice versa.

However, since as a matter of international comity, regulation of a U.S. person may be preferable to regulation of an affiliated non-U.S. person, where the swaps of a U.S. person are guaranteed by a non-U.S. person, the CFTC will consider the possibility that registration of the non-U.S. person may not be required if the U.S. person registers as an MSP. Furthermore, the CFTC may consider attributing the swaps positions of non-U.S. persons that are guaranteed by other non-U.S. persons to either the non-U.S. guarantor or the guaranteed non-U.S. person so long as all of the swaps positions triggering MSP registration are subject to MSP registration and regulatory requirements. The CFTC would not expect both entities to register as an MSP.

Finally, since the CFTC has determined that Basel-compliant capital standards are sufficiently comparable to, and as comprehensive as, capital oversight by the CFTC, the SEC or a U.S. banking regulator, the Final Guidance provides that, where a subsidiary is subject to Basel-compliant capital standards and oversight by a G20 prudential supervisor, the subsidiary's positions would generally not be attributed to a parental guarantor in the computation of the parent's outward exposure under the MSP definition.

No Double Counting of Cleared Swaps for SD or MSP Registration

The Final Guidance provides that when a non-U.S. person that is not a guaranteed affiliate or affiliate conduit clears a swap through a registered derivatives clearing organization

("DCO"), such non-U.S. person would generally not need to count both the resulting (novated) swap and the original swap against its SD *de minimis* threshold or MSP threshold, as long as the swap is counted at least once.

Definition of "Affiliate Conduit"

The Final Guidance defines "affiliate conduit" as an entity that functions as a conduit or vehicle for U.S. persons conducting swaps with third parties. The CFTC identifies the following factors as relevant to determining whether a non-U.S. person is an "affiliate conduit":

- The non-U.S. person is a "majority-owned affiliate" (as defined in Regulation 1.3(ggg)(6)(i)) of a U.S. person;
- The non-U.S. person is controlling, controlled by or under common control with the U.S. person;
- The financial results of the non-U.S. person are included in the consolidated financial statements of the U.S. person; and
- The non-U.S. person, in the regular course of business, engages in swaps with non-U.S. third parties for the purpose of hedging or mitigating risks faced by, or to take positions on behalf of, its U.S. affiliates, and enters into offsetting swaps or other arrangements with its U.S. affiliates in order to transfer the risks and benefits of such third-party swaps to its U.S. affiliates.

The CFTC also notes the following with respect to affiliate conduits:

- affiliates of SDs will generally not be considered affiliate conduits;
- an affiliate conduit will not necessary be guaranteed by its parent; and
- market participants may reasonably rely on counterparty representations as to its non-U.S. affiliate conduit status.

Swaps with Foreign Branches of U.S. Banks

For purposes of the Final Guidance, a "foreign branch" of a U.S. SD or MSP is any "foreign branch" (as defined in the applicable banking regulation) of a U.S. bank that: (1) is subject to Regulation K[17] or the FDIC International Banking Regulation[18] or otherwise designated

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[17] Regulation K, issued by the Board of Governors of the Federal Reserve, sets forth rules governing the international and foreign activities of U.S. banking organizations and defines a "foreign branch" as "an office of an organization (other than a representative office) that is located outside the country in which the organization is legally established and at which a banking or financing business is conducted."

as a "foreign branch" by the U.S. bank's primary regulator; (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 in which it is located (the "Foreign Branch Characteristics"). However, in addition to the Foreign Branch Characteristics, the CFTC will consider other relevant facts and circumstances in determining whether a foreign office of a U.S. bank is a "foreign branch."

The CFTC notes that a foreign branch of a U.S. bank would generally not include an affiliate of a U.S. bank that is incorporated or organized as a separate legal entity.

Factors in Determining Where the Swap Is Executed

Under the Final Guidance, in determining whether a swap executed by a U.S. bank through a foreign office should be considered to be "with a foreign branch" for purposes of the *de minimis* calculations for SD and MSP registration, the fact that the trade confirmation indicates that the swap was booked in the foreign branch is not relevant. Rather, in making this determination, all of the facts and circumstances are relevant. Specifically, if all of the following factors are present, the swap should generally be considered to be with the foreign branch (regardless of whether the counterparty is another foreign branch or a non-U.S. SD):

- The employees negotiating and agreeing to the terms of the swap (or, if executed electronically, managing execution of the swap), other than solely clerical or ministerial employees, are located in such foreign branch or in another foreign branch of the U.S. bank;
- The foreign branch or another foreign branch is the office through which the U.S. 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 the swap documentation specifies that the office for the U.S. bank is such foreign branch;
- The swap is entered into by such foreign branch in its normal course of business;
- The swap is treated as a swap of the foreign branch for tax purposes; and
- The swap is reflected in the local accounts of the foreign branch.

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[18] The FDIC International Banking Regulation (12 CFR 347), issued by the Federal Deposit Insurance Corporation, sets forth rules governing the operation of foreign branches of insured state nonmember banks and defines a "foreign branch" as "an office or place of business located outside the United States [and certain of] its territories . . . at which banking operations are conducted, but does not include a representative office."

However, if material terms of the swap are negotiated or agreed to by employees of the U.S. bank located in the United States, the swap should be considered to be with the U.S. bank.

Categorization of Entity-Level and Transaction-Level Requirements

The Final Guidance distinguishes between two types of Title VII swaps regulations applicable to SDs and MSPs: Entity-Level Requirements (which apply to the firm as a whole) and Transaction-Level Requirements (which apply to the individual swap transaction or trading relationship).

Entity-Level Requirements

Entity-Level Requirements consist of: (1) capital adequacy; (2) chief compliance officer, (3) risk management, (4) swap data recordkeeping, (5) swap data repository ("SDR") reporting under Part 45 of the Regulations and (6) physical commodity large swaps trader reporting ("Large Trader Reporting") under Part 20 of the Regulations.

The Entity-Level Requirements are split into two categories:

- *First Category Entity-Level Requirements*: (1) capital adequacy, (2) chief compliance officer, (3) risk management (including monitoring of position limits)[19] and (4) swap data recordkeeping under Regulations 23.201 and 23.203 (other than records relating to complaints and sales materials);
- *Second Category Entity-Level Requirements*: (1) SDR Reporting, (2) Large Trader Reporting and (3) swap data recordkeeping under Parts 43 and 46 of the Regulations (pertaining to real-time reporting and historical swaps) and certain aspects of swap data recordkeeping relating to complaints and sales materials under Regulations 23.201(b)(3) and 23.201(b)(4).

Transaction-Level Requirements

Transaction-Level Requirements consist of: (1) clearing and swap processing, (2) margin and segregation requirements for uncleared swaps, (3) mandatory trade execution, (4) swap trading relationship documentation, (5) portfolio reconciliation and compression, (6)

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[19] While position limits and anti-manipulation provisions are outside the scope of the Final Guidance, the monitoring of position limits under Regulation 23.601 is an Entity-Level Requirement.

real-time public reporting,[20] (7) trade confirmation, (8) daily trading records and (9) external business conduct standards.

The CFTC divides the Transaction-Level Requirements into:

- "Category A Transaction-Level Requirements" which include all the Transaction-Level Requirements except the external business conduct standards, and
- "Category B Transaction-Level Requirements" which are all the external business conduct standards.

Application of Entity-Level and Transaction-Level Requirements and Substituted Compliance

Applicability of Requirements and Availability of Substituted Compliance

The Final Guidance provides the following framework for the application of various Title VII requirements to SDs, MSPs and entities that are neither SDs nor MSPs ("Non-Registrants"), based on their status as U.S. or non-U.S. persons and other factors, as well as guidance as to when the CFTC may consider compliance with a comparable and comprehensive regulatory requirement of a foreign jurisdiction as a reasonable substitute for compliance with the corresponding Title VII requirements ("substituted compliance").

Summary of Entity-Level Requirements

U.S. SD or MSP (including an affiliate of a non-U.S. person).	Apply (Also applies when the U.S. SD or MSP is acting through a foreign branch (both Entity-Level and Transaction-Level Requirements are the ultimate responsibilities of the U.S.-based SD or MSP).)

[20] The CFTC notes that categorizing SDR Reporting as an Entity-Level Requirement and real-time reporting as a Transaction-Level Requirement might, in certain circumstances, preclude market participants from including Part 43 and Part 45 data for a transaction in a single report. Therefore, while real-time reporting will generally be treated as a Transaction-Level Requirement, the Final Guidance clarifies that market participants may apply real-time public reporting to transactions that are not necessarily subject to this requirement if it would be more efficient to do so.

Non-U.S. SD or MSP (including an affiliate of U.S. person).	First Category: Substituted Compliance Second Category: -Apply for U.S. counterparties -Substituted Compliance for SDR reporting with non-U.S. counterparties that are not guaranteed affiliates or affiliate conduits -Substituted Compliance (except for Large Trader Reporting) with non-U.S. counterparties. Note: Substituted compliance does not apply to Large Trader Reporting (*i.e.*, non-U.S. persons that are subject to part 20 would comply with it in the same way that U.S. persons comply). With respect to the SDR Reporting Requirement, the CFTC may make substituted compliance available only if direct access to swap data stored at a foreign trade repository is provided to the CFTC.

Summary of Category A Transaction-Level Requirements

	U.S. Person (other than Foreign Branch of U.S. Bank that is an SD or MSP)	**Foreign Branch of U.S. Bank that is an SD or MSP**	**Non-U.S. Person Guaranteed by, or Affiliate Conduit of, a U.S. Person**	**Non-U.S. Person Not Guaranteed by, and Not an Affiliate Conduit of, a U.S. Person**
U.S. SD or MSP (including an affiliate of a non-U.S. person)	Apply	Apply	Apply	Apply
Foreign Branch of U.S. Bank that is an SD or MSP	Apply	Substituted Compliance	Substituted Compliance[21]	Substituted Compliance[21]
Non-U.S. SD or MSP (including an affiliate of U.S. person)	Apply	Substituted Compliance	Substituted Compliance	Do Not Apply

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[21] Under a limited exception, even where there is not a comparable foreign regulatory regime, where a swap is between the foreign branch of a U.S. bank that is an SD or MSP and a non-U.S. person (that is not a guaranteed affiliate or affiliate conduit), the foreign branch may comply with the transaction-level requirements of the foreign jurisdiction in which it is domiciled or doing business if the aggregate notional value of the swaps of all foreign branches in such countries does not exceed 5% of the aggregate notional value of all the swaps of the U.S. SD, and the U.S. person maintains records with supporting information, as well as to identify, define, and address any significant risk that may arise from the non-application of the Transaction-Level Requirements. Where a swap between the foreign branch of a U.S. SD or MSP and a non-U.S. person (that is not a guaranteed affiliate or affiliate conduit) takes place in a foreign jurisdiction other than Australia, Canada, the European Union, Hong Kong, Japan, or Switzerland, the counterparties generally may comply only with the transaction-level requirements in the foreign jurisdiction where the foreign branch is located if the aggregate notional value of all the swaps of the U.S. SD's foreign branches in such countries does not exceed 5% of the aggregate notional value of all of the swaps of the U.S. SD, and the U.S. person maintains records with supporting information for the 5% limit and to identify, define, and address any significant risks that may arise from the non-application of the Transaction-Level Requirements."

Summary of Category B Transaction-Level Requirements

	U.S. Person (other than Foreign Branch of U.S. Bank that is an SD or MSP)	Foreign Branch of U.S. Bank that is an SD or MSP	Non-U.S. Person Guaranteed by, or Affiliate Conduit of, a U.S. Person	Non-U.S. Person Not Guaranteed by, and Not an Affiliate Conduit of, a U.S. Person
U.S. SD or MSP (including an affiliate of a non-U.S. person)	Apply	Apply	Apply	Apply
U.S. SD or MSP (when it solicits and negotiates through a foreign subsidiary or affiliate)	Apply	Do Not Apply	Do Not Apply	Do Not Apply
Foreign Branch of U.S. Bank that is an SD or MSP	Apply	Do Not Apply	Do Not Apply	Do Not Apply
Non-U.S. SD or MSP (including an affiliate of U.S. person)	Apply	Do Not Apply	Do Not Apply	Do Not Apply

Summary of Non-Registrant Requirements

	U.S. Person (including an affiliate of a non-U.S. person)	Non-U.S. Person Guaranteed by, or Affiliate Conduit of, a U.S. Person	Non-U.S. Person Not Guaranteed by, or Affiliate Conduit of, by U.S. Person
U.S. Person (including an affiliate of a non-U.S. person)	Apply	Apply	Apply
Non-U.S. Person Guaranteed by, or Affiliate Conduit of, U.S. person	Apply	Substituted Compliance, with limitations: -Does not apply to Large Trader Reporting (i.e., non-U.S. persons that are subject to part 20 would comply with it in the same way that U.S. persons comply). -With respect to the SDR Reporting Requirement, the CFTC may permit substituted compliance only if direct access to swap data stored at a foreign trade repository is provided to the CFTC.	Do Not Apply
Non-U.S. Person Not Guaranteed by, or Affiliate Conduit[1] of, U.S. Person	Apply	Do Not Apply	Do Not Apply

- *U.S. SD or MSP*:
  - A U.S. SD or MSP (including an affiliate of a non-U.S. person that is registered as such) must comply in full with all of the Entity-Level Requirements and Transaction-Level Requirements and substituted compliance will generally not be available, regardless of the counterparty (subject to certain exceptions with respect to Transaction-Level Requirements for swaps entered into by a U.S. SD or MSP through a foreign branch).
  - Where a U.S. SD or MSP enters into a swap through its foreign branch, it must:
    - comply with all Entity-Level Requirements, without substituted compliance, when the SD or MSP is a U.S. bank acting through its foreign branch;
    - comply with Category A Transaction-Level Requirements, with substituted compliance available if (i) the swap is between two foreign branches of U.S. banks that are both SDs or MSPs or (ii) the swap is between a foreign branch of a U.S. bank that is an SD or MSP and a non-U.S. person (regardless of whether the non-U.S. person is a guaranteed affiliate or an affiliate conduit); and
    - comply with Category B Transaction-Level Requirements only if the counterparty to the swap is a U.S. person (other than a foreign branch of a U.S. SD or MSP), without substituted compliance. Where the U.S. SD or MSP enters into a swap through its foreign branch with a non-U.S. person or a foreign branch of a U.S. SD or MSP, it is not required to comply with such requirements.
  - Where a U.S. SD or MSP enters into a swap through its foreign branch with a non-U.S. person (that is not a guaranteed affiliate or an affiliate conduit) and the transaction takes place in a foreign jurisdiction other than Australia, Canada, the European Union, Hong Kong, Japan and Switzerland (the "Specified Jurisdictions[22]"), the counterparties may, in lieu of complying with the Transaction-Level Requirements, comply with corresponding requirements applicable to entities domiciled or doing business in jurisdiction where the foreign branch is located if: (1) the aggregate notional value (in U.S. Dollars), measured on a quarterly basis, of the swaps of all of the U.S. SD's foreign branches in foreign jurisdictions other than the Specified Jurisdictions does not exceed 5% of the aggregate notional value of all of the U.S. SD's swaps and (2) the U.S. person maintains records with supporting information to verify that this remains true and

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[22] Market participants or regulators in the Specified Jurisdictions have submitted requests for substituted compliance determinations.

to identify, define and address any significant risk that may arise from the non-application of the Transaction-Level Requirements.

- *Non-U.S. SD or MSP and Entity-Level Requirements*: A non-U.S. SD or MSP (including an affiliate of a U.S. person) must comply with all Entity-Level Requirements but substituted compliance and other relief may be available as follows:
  - For First Category Entity-Level Requirements, substituted compliance may be available regardless of the counterparty:
    - With respect to Regulations 3.3 (chief compliance officer), 23.600 (risk management program), 23.601 (monitoring of position limits), 23.602 (diligent supervision), 23.603 (business continuity and disaster recovery) and 23.606 (disclosure and inspection) in particular, the CFTC will consider relief, subject to conditions and restrictions to be determined, that would permit guaranteed affiliates in a corporate group under common control that do not enter into swaps with U.S. persons (or guaranteed affiliates or affiliate conduits) to comply with such requirements by establishing a single set of policies, procedures, governance structures, reporting lines, operational units and systems on a consolidated basis, rather than individually for each SD in the group. Any such relief would require a consolidated program to manage the risks of the included guaranteed affiliates on an individual, rather than net, basis. Parties should contact the Director of the CFTC's Division of Swap Dealer and Intermediary Oversight ("DSIO") to discuss such relief.
  - For Second Category Entity-Level Requirements (other than Large Trader Reporting), substituted compliance is available only where the counterparty is a non-U.S. person (and not where the counterparty is a U.S. person):
    - With respect to SDR Reporting in particular, substituted compliance should be available only if: (1) the non-U.S. counterparty is not a guaranteed affiliate or affiliate conduit and (2) the CFTC has direct access (including electronic access) to the relevant swap data that is stored at the foreign trade repository.[23]
  - Substituted compliance is not available for Large Trader Reporting.
- *Non-U.S. SD or MSP and Transaction-Level Requirements*: The following guidance applies to swaps entered into by a non-U.S. SD or MSP (including an affiliate of a U.S. person that is registered as such):

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[23] "Direct access" will generally include, at a minimum, real time, direct electronic access to the data and the absence of any legal impediments to the CFTC's access to such data.

- When entering into a swap with a U.S. person (other than a foreign branch of a U.S. SD or MSP), the non-U.S. SD or MSP must comply with all Transaction-Level Requirements, without substituted compliance, except that:
  - where such a swap is executed anonymously on a registered DCM or SEF, or on an FBOT registered with the CFTC under Part 48 of the Regulations, and is cleared, the non-U.S. person: (a) will be deemed to have satisfied all Category A Transaction-Level Requirements (as applicable) and neither party will need to take any further steps to comply with such requirements in connection with the swap and (b) will not be subject to the Category B Transaction-Level Requirements; and
  - where the non-U.S. SD or MSP complies with requirements in its home jurisdiction that are "essentially identical" to the relevant Title VII requirements, it will be deemed to be in compliance with the relevant Title VII requirements. Whether a jurisdiction's requirements are essentially identical to the Title VII requirements will be evaluated on a provision-by-provision basis.[24]
- When entering into a swap with a foreign branch of a U.S. bank that is an SD or MSP, the non-U.S. SD or MSP must comply with all Category A Transaction-Level Requirements but substituted compliance is available. The parties to such a swap are not required to comply with Category B Transaction-Level Requirements.
- When entering into a swap with a non-U.S. person whose performance is guaranteed[25] (or otherwise supported) by a U.S. person (including a guaranteed affiliate), the non-U.S. SD or MSP must comply with all Category A Transaction-Level Requirements but substituted compliance is available. The parties to such a swap are not required to comply with Category B Transaction-Level Requirements (regardless of whether the non-U.S. counterparty is a guaranteed affiliate or affiliate conduit).
- When entering into a swap with a (non-U.S. person) affiliate conduit, if the parties elect the Inter-Affiliate Clearing Exemption, they need only comply with the

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24 This determination may be made by CFTC action or staff no-action relief. As discussed below, the CFTC recently a "Risk Mitigation No-Action Letter" based on its finding that the CFTC and the European Union have essentially identical risk mitigation rules. Thus where a swap is subject to concurrent jurisdictions under US and EU risk mitigation rules, compliance with "risk mitigation" under the European Market Infrastructure Regulation will achieve the same compliance with CFTC regulations.

25 The CFTC declined to limit this interpretation to certain types of guarantees (*e.g.*, "full recourse" guarantees or guarantees that may have a material impact on the guarantor), noting that even partial recourse guarantees are an "integral part" of a guaranteed swap. It is sufficient that the non-U.S. SD or MSP would have recourse to the U.S. guarantor in connection with its swaps position.

conditions of such exemption, including the outward-facing swaps condition and the Part 43 real-time reporting requirements. (The same guidance applies when the non-U.S. SD or MSP is itself an affiliate conduit, even if the counterparty is not).

- When entering into a swap with a non-U.S. person that is not a guaranteed affiliate or an affiliate conduit (and whose performance is not otherwise supported by a U.S. person), the non-U.S. SD or MSP is not required to comply with any Transaction-Level Requirements.

- *Non-Registrants (Non-SD/MSPs)*: Certain Title VII requirements also apply to Non-Registrants—namely, clearing, trade execution,[26] real-time reporting, Large Trade Reporting, SDR Reporting and swap data recordkeeping (the "Non-Registrant Requirements").

Where two Non-Registrants enter into a swap:

- If one (or both) of the counterparties is a U.S. person, the parties must comply with all Non-Registrant Requirements without substituted compliance.[27] However, if such a swap is executed anonymously on a registered DCM or SEF, or on a registered FBOT, and is cleared, the parties need not comply with the Non-Registrant Requirements, with the exception of Large Trader Reporting, SDR Reporting and swap data recordkeeping.
- If both counterparties are non-U.S. persons, the following guidance applies:
  - *Large Trader Reporting*: If a counterparty is a non-U.S. clearing member that holds positions in physical commodity swaps subject to Large Trader Reporting that are significant enough to trigger routine reporting obligations and recordkeeping obligations under Part 20, it must comply with such reporting and recordkeeping obligations;
  - *Other Non-Registrant Requirements*:
    - If each of the counterparties is either a guaranteed affiliate or an affiliate conduit, they must comply with all Non-Registrant Requirements but

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[26] The Final Guidance provides that if the CFTC's trade execution requirement is triggered before March 15, 2014, the CFTC will, through no-action letters, extend time-limited transitional relief to certain EU-regulated multilateral trading facilities ("MTFs"), which would be available through March 15, 2014 for MTFs that meet certain requirements set forth in the Final Guidance. Additionally, the CFTC will consult with the European Commission regarding the possibility of granting relief to EU-regulated trading platforms that are subject to requirements that achieve regulatory outcomes comparable to those achieved by the Title VII requirements applicable to SEFs.

[27] For additional detail on the CFTC's process for determining comparability of a foreign jurisdiction's clearing mandate, see our client memorandum, "Final CFTC Rules on Clearing Exemption for Swaps Between Certain Affiliated Entities" http://www.debevoise.com/newseventspubs/publications/detail.aspx?id=2dc4b916-e5aa-40ad-be3d-681a597079d3

substituted compliance is available for each requirement other than Large Trader Reporting. (SDR Reporting will be eligible for substituted compliance only if the CFTC has direct access to all of the reported swap data elements that are stored at the foreign trade repository).

- If neither or only one of the counterparties is a guaranteed affiliate or an affiliate conduit, they are not required to comply with the Non-Registrant Requirements (other than Large Trader Reporting).
- Notwithstanding the above, if at least one party is an affiliate conduit and the parties elect the Inter-Affiliate Clearing Exemption, they need only comply with the conditions of such exemption, including the outward-facing swaps condition and Large Trader Reporting.

Substituted Compliance Determinations

Generally

Under the Final Guidance, if the CFTC determines that certain laws and regulations of a foreign jurisdiction are comparable to and as comprehensive as a corresponding category of U.S. laws and regulations (a "Substituted Compliance Determination"), an entity in that foreign jurisdiction may comply with the foreign laws and regulations in lieu of complying with the relevant U.S. laws and regulations, subject to the CFTC's retention of its examination[28] and enforcement authority.

Where a Substituted Compliance Determination has been made with respect to a given Title VII requirement, the Final Guidance permits the following types of entities to rely on such determination: (1) a non-U.S. SD or MSP, (2) a U.S. SD or MSP with respect to its foreign branches and (3) a non-U.S. non-registrant that is a guaranteed affiliate or affiliate conduit.

The CFTC will rely on a "outcomes-based approach" in determining whether the foreign requirements achieve the same regulatory objectives as the Dodd-Frank Act, taking into account all relevant factors including, without limitation: the comprehensiveness of such requirements, the scope and objectives of such requirements and the comprehensiveness of the foreign regulator's supervisory compliance program, as well as the foreign jurisdiction's authority to support and enforce its oversight of the person(s) relying on

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[28] Under Regulations 23.203 and 23.606, all records required by the CEA and the Regulations to be maintained by a registered SD or MSP must be maintained in accordance with Regulation 1.31 and must be open for inspection by the CFTC, the Department of Justice or any applicable prudential regulator.

such determination. The CFTC will not require that the foreign jurisdiction's requirements be identical to the Title VII requirements.

In part because many foreign jurisdictions have been implementing OTC derivatives reforms in an incremental manner, the CFTC's determination may be made on a requirement-by-requirement basis, rather than on the basis of the foreign regime as a whole. Thus, entities relying on substituted compliance for certain requirements may be required to comply with certain Title VII requirements for which a Substituted Compliance Determination has not yet been made or for which the CFTC has determined that comparability is lacking. Additionally, in making such determinations, the CFTC may include conditions that take into account timing and other issues related to coordinating the implementation of reform efforts across jurisdictions.

The CFTC's approach to making such a determination will vary by jurisdiction. For instance, the CFTC may coordinate with foreign regulators in developing appropriate regulatory changes or new regulations, particularly where such changes or new regulations are already being considered or proposed by the foreign regulator or legislature. As another example, in order to avoid conflicts or inconsistent regulatory obligations, the CFTC may include in its Substituted Compliance Determination a description of the means by which substituted compliance may be achieved within the construct of the foreign regulatory regime. Additionally, the determination may include provisions for summary compliance and risk reporting to the CFTC to allow the CFTC to monitor whether the regulatory outcomes are being achieved.

Substituted Compliance Determinations for SDR Reporting and real-time public reporting will generally take into account whether the CFTC may effectively access and use data stored in foreign trade repositories, both in isolation and when compared to and aggregated with swap data from other foreign trade repositories and registered SDRs. At a minimum, effective use requires that data elements stored in foreign repositories are sufficient to permit comparison and aggregation, and that all transactions with comparable required data elements (otherwise required to be reported to a registered SDR) are available to the foreign repository.

Process for Substituted Compliance Determinations

A Substituted Compliance Determination will be based on a comparison of specific foreign requirements against specific related Title VII requirements in 13 categories. After receiving a submission from an applicant, the determination will be made as to each of the 13 categories of regulatory obligations, as appropriate.

The following persons may apply for substituted compliance, either individually or collectively: (1) foreign regulators; (2) a non-U.S. entity or group thereof; (3) a U.S. bank that is an SD or MSP with respect to its foreign branches; and/or (4) a trade association, or other group, on behalf of similarly-situated entities. Once a Substituted Compliance Determination is made for a jurisdiction, it will apply for all entities or transactions in that jurisdiction to the extent provided in the determination.

The applicant should, at a minimum, state with specificity the factual and legal basis for requesting the determination (including all applicable legislation, rules and policies) and provide an assessment of whether the objectives of the two regimes are comparable and comprehensive. If the applicant is a registered SD or MSP, it should also describe the capacity in which it is licensed with its regulator(s) in its home country and whether it is in good standing. The applicant should also notify the CFTC of any material changes to the information submitted.

Further, the CFTC expects that it would enter into a supervisory memorandum of understanding ("MOU") or similar arrangement with the relevant foreign regulator(s) that provides for information sharing and cooperation in the context of supervising SDs and MSPs, including a description of ongoing coordination activities (*e.g.*, procedures for confirming continuing oversight activities, access to information, onsite visits and notification procedures).

Within four years of issuing any Substituted Compliance Determination, the CFTC will reevaluate its initial determination to determine whether any changes should be made and will reissue the relevant action, conditionally or unconditionally, as appropriate.

Conflicts Arising from Privacy and Blocking Laws

Conflicts between Title VII requirements and the privacy and blocking[29] laws of some foreign jurisdictions may limit or prohibit the disclosure of data that is required to be reported under the Dodd-Frank Act (such as a non-reporting counterparty's identity, under Parts 45 and 46). The Final Guidance provides that the CFTC may consider "reasonable alternatives" that allow it to "fulfill its mandate while respecting the regulatory interests of other jurisdictions." Where a real conflict exists, the CFTC strongly encourages regulators and registrants to consult directly with CFTC staff.

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[29] While in some jurisdictions, a privacy restriction may be overcome if the counterparty consents to disclosure, in others, the restriction may take the form of a blocking statute which serves as an absolute prohibition on such disclosure, creating a direct conflict with the Title VII requirement.

Clearing

Section 5b(h) of the CEA provides the CFTC with discretionary authority to exempt DCOs, conditionally or unconditionally, from the applicable DCO registration requirements. Thus, the CFTC has discretion to exempt from registration DCOs that, at a minimum, are subject to comparable and comprehensive supervision by another regulator. The Final Guidance provides that the following conditions, among others, may have to be met for a clearing organization to qualify as an exempt DCO: (1) the CFTC having entered into an appropriate MOU or similar arrangement with the relevant foreign supervisor in the clearing organization's home country and (2) the clearing organization having been assessed to be in compliance with the Principles of Financial Market Infrastructures ("PFMIs").

Additionally, with respect to the exemption from mandatory clearing for certain inter-affiliate swaps ("Inter-Affiliate Clearing Exemption") set forth in Regulation 50.52,[30] the Final Guidance provides that, under certain circumstances, the CFTC will permit a non-U.S. person "eligible affiliate counterparty" (as defined in Regulation 50.52(a)) to satisfy the "outward-facing swaps condition" in Regulation 50.52(b)(4)(i)[31] for swaps entered into with an unaffiliated non-U.S. person that is not otherwise subject to the CEA (a "Foreign End-User") by electing the "end-user exception" in section 2(h)(7) of the CEA even though certain conditions of such exception set forth in section 2(h)(7)(A) of the CEA do not technically apply to such Foreign End-User (since it is not subject to the CEA).

Specifically, the Foreign End-User may elect not to clear the swap if: (1) neither the Foreign End-User nor the non-U.S. person counterparty is located in a foreign jurisdiction in which the CFTC has determined that a comparable and comprehensive clearing requirement exists and that the exceptions and/or exemptions thereto are comparable and comprehensive; (2) the Foreign End-User is not a financial entity as provided in section

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30 *See* our client memorandum, "Final CFTC Rules on Clearing Exemption for Swaps Between Certain Affiliated Entities," http://www.debevoise.com/newseventspubs/publications/detail.aspx?id=2dc4b916-e5aa-40ad-be3d-681a597079d3

31 The "outward facing swaps condition" provides that, in order to rely on the Inter-Affiliate Clearing Exemption for an inter-affiliate swap, each counterparty that enters into a swap that is subject to mandatory clearing with an unaffiliated counterparty must either comply with the clearing requirements under section 2(h) of the CEA (or an exception or exemption therefrom, such as the end-user exception) or with a comparable and comprehensive foreign clearing mandate (or an exception or exemption therefrom), or clear the swap through a registered DCO or a clearing organization that has been assessed to be in compliance with PFMIs.

2(h)(7)(A)(i) of the CEA; and (3) the Foreign End-User enters into the swap to hedge or mitigate commercial risk, as provided in section 2(h)(7)(A)(ii) of the CEA.[32]

CROSS-BORDER EXEMPTIVE ORDER

"U.S. Person" Definition

In the release accompanying the Exemptive Order (the "Exemptive Order Release"), the CFTC acknowledges that, since the definition of the term "U.S. person" in the January Order is no longer available, market participants need additional time to adjust their operational and compliance systems in order to incorporate the revised scope of that term. Therefore, under the Exemptive Order, the definition of the term "U.S. person" contained in the January Order[33] will continue to apply from July 13, 2013 until 75 days after the Final Guidance is published in the Federal Register.

As described above, the "U.S. person" definition in the January Order is identical to the U.S. person definition in the Final Guidance, with the following exceptions:

- Unlike the Final Guidance, the January Order did not include a prong for Specified Legal Entities (other than certain limited liability entities) that are majority-owned by a U.S. person or persons (other than a U.S. Commodity Pool) bearing unlimited responsibility for the entity's obligations and liabilities;
- Unlike the Final Guidance, the January Order did not include a prong for a collective investment vehicle that is not a Specified Legal Entity and that is majority-owned by U.S. person(s) (other than any vehicle that is publicly offered only to non-U.S. persons and not offered to U.S. persons); and
- Unlike the Final Guidance, the Specified Legal Entities prong of the January Order stated that the "principal place of business" test did not apply to funds or collective investment vehicles.

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[32] The Foreign-End-User need not satisfy the provisions of section 2(h)(7)(A)(iii) which require the non-financial entity relying on the end-user exception to notify the CFTC how it generally meets its financial obligations associated with uncleared swaps.

[33] While the Exemptive Order is silent on the subject, the January Order permitted a party to a swap to rely on its counterparty's representations in determining whether such counterparty is a U.S. person as long as such reliance was reasonable.

Swap Dealer and Major Swap Participant Calculations

***De Minimis* Calculation**

The Exemptive Order provides that, until 75 days after the Final Guidance is published in the Federal Register, a non-U.S. person (regardless of whether such non-U.S. person is guaranteed by a U.S. person) is not required to include in its calculation of the aggregate gross notional amount of swaps connected with its swap dealing activity for purposes of Regulation 1.3(ggg)(4) or in its calculation of whether it is an MSP for purposes of Regulation 1.3(hhh) any swaps where the counterparty is a non-U.S. person, or any swap where the counterparty is a foreign branch of a U.S. person that is registered as an SD.

Aggregation

The January Order provided a temporary exemption from certain aspects of the SD Aggregation Requirement and the Exemptive Order permits all non-U.S. persons to apply the aggregation principle applied in the January Order until 75 days after the Final Guidance is published in the Federal Register.

Specifically, the Exemptive Order provides that, during that period, a non-U.S. person that was engaged in swap dealing activities with U.S. persons as of December 21, 2012 is not required to include, for purposes of the *de minimis* test, the aggregate gross notional amount of swaps connected with the swap dealing activity of its U.S. affiliates under common control.[34]

Additionally, during that same period, a non-U.S. person that was engaged in swap dealing activities with U.S. persons as of December 21, 2012 and is an affiliate under common control with a person that is registered as an SD is not required to include, for purposes of the *de minimis* test, the aggregate gross notional amount of swaps connected with the swap dealing activity of any non-U.S. affiliate under common control that either (1) was engaged in swap dealing activities with U.S. persons as of December 21, 2012 or (2) is registered as an SD.

Finally, during that same period, a non-U.S. person is not required to include, for purposes of the *de minimis* test, the aggregate gross notional amount of swaps connected with the

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[34] For these purposes, the CFTC construes "affiliates" to include persons under "common control" as stated in the Final Entity Definitions Rules, which define control as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract or otherwise."

swap dealing activity of its non-U.S. affiliates under common control with other non-U.S. persons as counterparties.

Swap Dealer Registration

The Exemptive Order provides that a non-U.S. person that was previously exempt from registration as an SD because of the temporary relief provided under the January Order, but that is required to register as an SD under Regulation 1.3(ggg)(4) due to changes to the scope of the term "U.S. person" or changes in the *de minimis* SD calculation or aggregation for purposes of the *de minimis* calculation, is not required to register as an SD until two months after the end of the month in which such person exceeds the *de minimis* threshold for SD registration.

Relief from Entity-Level and Transaction-Level Requirements

Categorization

For purposes of the Exemptive Order, the Title VII provisions applicable to SDs and MSPs are categorized as Entity-Level or Transaction-Level Requirements in the same way as they are categorized in the Final Guidance, except that, since substituted compliance is not possible with respect to Large Trader Reporting requirements, such requirements are not considered "Entity-Level Requirements" for purposes of the Exemptive Order.

The CFTC has not yet finalized regulations regarding capital adequacy or margin and segregation for uncleared swaps. If the CFTC finalizes such regulations before December 21, 2013, non-U.S. SDs and MSPs would be required to comply with such requirements in accordance with the compliance date(s) provided in the relevant rulemaking(s).

Application of Entity-Level Requirements

In the Exemptive Order Release, the CFTC notes that market participants or regulators in the Specified Jurisdictions recently submitted requests for Substituted Compliance Determinations and that, since the CFTC has not had sufficient time to review and reach a final determination prior to issuing the Final Guidance, it has decided to temporarily delay compliance with Entity-Level Requirements in the Specified Jurisdictions. Thus, under the Exemptive Order, a non-U.S. SD or MSP established in one of the Specified Jurisdictions may defer compliance with any Entity-Level Requirement for which substituted compliance would be possible (as described in the Final Guidance) until the earlier of December 21, 2013 or 30 days after the issuance of a Substituted Compliance Determination for the relevant regulatory requirements of the jurisdiction, except as provided below with respect to SDR reporting.

With respect to SDR reporting, the Exemptive Order provides that non-U.S. SDs and MSPs established in any of those Specified Jurisdictions that are not part of an affiliated group in which the ultimate parent entity is a U.S. SD, U.S. MSP, U.S. bank, U.S. financial holding company, or U.S. bank holding company may temporarily delay compliance with the SDR reporting requirements of Part 45 and 46 of the Regulations with respect to swaps with non-U.S. counterparties, *provided* that, throughout the relief period (which expires on the earlier of December 21, 2013 or 30 days after of the issuance by the CFTC of a Substituted Compliance Determination for the Part 45 and 46 requirements for the relevant jurisdiction):

- such non-U.S. SDs and MSPs are in compliance with the swap data recordkeeping and reporting requirements of their home jurisdictions; or
- where no swap data reporting requirements have been implemented in their home jurisdictions, such non-U.S. SD or MSP complies with the recordkeeping requirements of Regulations 45.2, 45.6, 46.2 and 46.4.

Application of Transaction-Level Requirements

Application to U.S. SDs and MSPs

The Exemptive Order permits foreign branches of U.S. banks to defer compliance with Category A Transaction-Level Requirements if the foreign branch is located in one of the Specified Jurisdictions (for which the CFTC has received or expects to soon receive a request for a Substituted Compliance Determination)[35]. Specifically, subject to certain exceptions, until the earlier of December 21, 2013 or 30 days after the issuance of a Substituted Compliance Determination for the relevant regulatory requirements of the relevant foreign jurisdiction, a foreign branch of a U.S. SD or MSP located in one of the Specified Jurisdictions may comply with any law and regulations of the jurisdiction in which it is located for the relevant Transaction-Level Requirement in lieu of complying with any Category A Transaction-Level Requirement for which substituted compliance would be possible under the Final Guidance.

This exemption does not apply, however, with respect to the following swaps ("Non-Exempt Swaps"):

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[35] The CFTC notes that if an SD or MSP established in any other foreign jurisdiction files a registration application before December 21, 2013, the CFTC may consider a request for deferring compliance with the Transaction-Level Requirements if a substituted compliance request is filed concurrently with such application.

- a swap that is subject to (1) mandatory clearing[36] under section 2(h)(1) of the CEA, Part 50 of the Regulations and Regulation 23.506 or (2) a trade execution requirement under section 2(h)(8) of the CEA and Regulations 37.12 and 38.11; or
- a swap with a guaranteed affiliate of a U.S. person with regard to real-time reporting requirements of Part 43 of the Regulations.

For swaps that are subject to mandatory clearing under section 2(h)(1) of the CEA, Part 50 of the Regulations and Regulation 23.506, any foreign branch of a U.S. bank that is an SD or MSP that would have been required to comply with such clearing requirement but for the January Order may delay complying with such clearing requirement until 30 days after the publication of the Final Guidance in the Federal Register.

For swaps with guaranteed affiliates of a U.S. person, until September 30, 2013, a foreign branch of a U.S. SD or MSP located in a Specified Jurisdiction may comply with the law and regulations of the jurisdiction in which it is located related to real-time reporting in lieu of complying with the real-time reporting requirements of Part 43 of the Regulations.

Application to Non-U.S. SDs and MSPs

The Exemptive Order provides that, subject to certain exceptions, until the earlier of December 21, 2013 or 30 days after the issuance of a Substituted Compliance Determination for the relevant regulatory requirements of the relevant jurisdiction, non-U.S. SDs and MSPs established in a Specified Jurisdiction[37] may comply with any law and regulations of its home jurisdiction in lieu of complying with any Category A Transaction-Level Requirement for which substituted compliance would be possible under the Final Guidance. This exemption does not apply, however, with respect to Non-Exempt Swaps.

For swaps that are subject to mandatory clearing, any non-U.S. SD or MSP that would have been required to comply with such clearing requirement but for the January Order may delay compliance until 30 days after the publication of the Final Guidance in the Federal Register.

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[36] The CFTC is authorized under section 2(h)(2) of the CEA to determine from time to time that a particular swap or group, category, type or class of swaps is required to be cleared. As of today, mandatory clearing is limited to four classes of interest rate swaps and two classes of credit default swaps listed in Regulation 50.4. For a list of swaps subject to mandatory clearing, see Appendix B to our client memorandum, "Recent Developments Regarding CICI Requirements and Looming Deadlines for Compliance by End-Users of Swaps," http://www.debevoise.com/newseventspubs/publications/detail.aspx?id=a80a0ca5-96ee-42e9-95b5-0098fb68ef32

[37] The CFTC notes that if an SD or MSP established in any other foreign jurisdiction files a registration application before December 21, 2013, the CFTC may consider a request for deferring compliance with the Transaction-Level Requirements if a substituted compliance request is filed concurrently with such application.

For swaps with guaranteed affiliates of a U.S. person, a non-U.S. SD or MSP established in a Specified Jurisdiction may comply with any law and regulations of its home jurisdiction related to real-time reporting requirements in lieu of complying with the real-time reporting requirements of Part 43 of the Regulations, until September 30, 2013.

FOUR NO-ACTION LETTERS

On July 11, 2013, the CFTC issued four no-action letters[38] addressing swaps regulation, following the announcement of a common "Path Forward" for the United States and the European Union on a package of measures for how to approach cross-border derivatives.

Relief for Clearing Organizations

Two of the letters were issued by the CFTC's Division of Clearing and Risk ("DCR") to two European-based clearing organizations to facilitate their provision of certain clearing services to clearing members that are U.S. persons, during the pendency of their DCO registration applications.

The no-action letters provide that DCR will not recommend that the CFTC take enforcement action against:

- (1) LCH.Clearnet SA, a French subsidiary of LCH.Clearnet Group Limited, for failure to register as a DCO under section 5b(a) of the CEA with respect to clearing certain credit default swaps on a broad-based index of reference entities ("Index CDS") or (2) any U.S. clearing member thereof for failure to clear its proprietary Index CDS business through a registered DCO.
- (1) Eurex Clearing AG, a German clearinghouse for Eurex Deutschland transactions, for failure to register as a DCO under section 5b(a) of the CEA with respect to clearing certain interest rate swaps ("IRS") and certain Index CDS[39] or (2) any U.S. clearing member thereof for failure to clear its proprietary IRS and Index CDS business through a registered DCO.

This relief will expire on the earlier of (1) December 31, 2013 or (2) the date on which the CFTC approves the relevant clearinghouse's pending application for DCO registration.

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38 *See* CFTC Letters 13-43, 13-44, 13-45 and 13-46, http://www.cftc.gov/PressRoom/PressReleases/pr6642-13

39 The no-action relief applies only to the specific IRS and Index CDS currently accepted for clearing by Eurex Clearing AG, which are identified in an attachment to the no-action letter.

Relief for Swap Dealers and Major Swap Participants from Risk Mitigation Requirements

A third no-action letter (the "Risk Mitigation No-Action Letter") issued by DSIO provides relief from designated risk mitigation requirements applicable to registered SDs and MSPs organized or established in the United States or the European Union with respect to certain transactions when such transactions are subject to both section 4s of the CEA and Article 11 of the European Market Infrastructure Regulation ("EMIR"). Accordingly, the relief is available for swap transactions[40] where (1) one of the counterparties is established in the European Union or otherwise subject to EMIR; (2) one of the counterparties is a U.S. person; and (3) one of the counterparties is an SD or MSP registered with the CFTC. The relief is also available in other circumstances where swaps are subject to both CFTC Risk Mitigation Rules and EMIR Risk Mitigation Rules, such as swaps between an SD or MSP established in the European Union and a guaranteed affiliate of a U.S. person.

The relief is limited to swaps ("Covered Swaps") that are either (1) uncleared swaps or (2) physically-settled foreign exchange forwards and swaps that have been exempted from the definition of "swap" by the U.S. Department of the Treasury.

The relief applies to SDs and MSPs for whom, under both regimes, the requirements are "essentially identical." DSIO has determined that Regulations 23.501 (swap confirmation), 23.502 (other than 23.502(c)) (portfolio reconciliation), 23.503 (portfolio compression), 23.504(b)(2) and 23.504(b)(4) (swap trading relationship documentation) (collectively, the "CFTC Risk Mitigation Rules"), codified in Subpart I of Part 23 of the Regulations, are essentially identical to provisions set forth under Article 11 of EMIR and the related technical standards ("EMIR Risk Mitigation Rules"). Therefore, DSIO will not recommend an enforcement action against an SD or MSP for failure to comply with the CFTC Risk Mitigation Rules when entering into Covered Swaps, so long as the SD or MSP complies with (1) the applicable EMIR Risk Mitigation Rules and (2) all requirements of Subpart I of Part 23 of the Regulations that are otherwise applicable to the SD or MSP.

Relief for Foreign Boards of Trade

Finally, the CFTC's Division of Market Oversight ("DMO") issued a no-action letter expanding the relief previously provided under the terms of the 16 existing CFTC direct access no-action letters. Pursuant to the previous no-action letters, an FBOT may permit identified members or other participants located in the United States to enter trades

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[40] The term "swap transaction" has the same meaning as in Regulation 23.500(l): "any event that results in a new swap or in a change in the terms of a swap, including execution, termination, assignment, novation, exchange, transfer, amendment, conveyance or extinguishing of rights or obligations of a swap."

directly into the trade matching system of the FBOT only with respect to futures and option contracts. By contrast, an FBOT registered pursuant to Part 48 of the Regulations may also list swap contracts for trading by direct access, subject to certain conditions. Given the resources and time required to properly assess the numerous registration applications that have been filed with the CFTC, the new no-action letter amends the previous letters to permit unregistered FBOTs to list swap contracts for trading by direct access, subject to certain conditions set forth in the letter.

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Please feel free to contact us with any questions.

July 24, 2013