

## **CFTC ISSUES PROPOSED GUIDANCE ON THE CROSS-BORDER APPLICATION OF THE COMMODITY EXCHANGE ACT TO SWAP TRANSACTIONS**

July 3, 2012

To Our Clients and Friends:

On June 29, 2012, the Commodity Futures Trading Commission (the “CFTC”) unanimously voted to propose interpretative guidance on the cross-border application of the swap provisions of the Commodity Exchange Act (the “CEA”), as mandated by the Wall Street Transparency and Accountability Act of 2010 (the “Dodd-Frank Act”) and related policy statement (the “Proposed Interpretative Guidance”). The CFTC issued the Proposed Interpretive Guidance under section 2(i) of the CEA, which provides that the provisions added by the Dodd-Frank Act will not apply to activities outside the United States unless those activities (1) have a direct and significant connection with activities in, or effect on, commerce of the United States, or (2) contravene such rules or regulations as the CFTC may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of the CEA that was enacted by the Dodd-Frank Act.

The Proposed Interpretative Guidance is open for public comment for 45 days after its publication in the Federal Registry. As of the date of this client update, it has not been published yet.

### **PRINCIPAL ISSUES ADDRESSED BY PROPOSED INTERPRETATIVE GUIDANCE**

The CFTC addresses the following issues in this Proposed Interpretative Guidance:

- Interpretation of the term “U.S. Person.”
- Guidance on when a non-U.S. Person’s swap activities require it to register as a swap dealer (“Swap Dealer”) or a major swap participant (“Major Swap Participant”).
- Guidance on the treatment for registration purposes of foreign branches, agencies, affiliates and subsidiaries of U.S. Swap Dealers and of U.S. branches of non-U.S. Swap Dealers.

- Guidance on cross-border applicability of the swap provisions under the CEA on an entity level or transaction level.
- The situations under which a non-U.S. Swap Dealer or Major Swap Participant or a non-U.S. branch or affiliate of a U.S. Swap Dealer will be permitted to comply with comparable and comprehensive foreign regulatory requirements instead of the regulatory requirements of the CEA, and proposed procedure for such non-U.S. Person to seek the CFTC's recognition of the foreign regulatory requirements.
- Applicability of the clearing, trading and certain reporting requirements of the CEA to cross-border swaps between counterparties that are neither Swap Dealers nor Major Swap Participants.

#### **WHO IS A U.S. PERSON?**

Generally, the CFTC proposes to interpret the term "U.S. Person" based on the extent to which the swap activities or transactions involving such person have an effect on US commerce. The proposed definition includes:

- Any natural person who is a resident of the United States.
- Any corporation, partnership, limited liability company, business or other trust, association, joint-stock company, fund or any form of enterprise similar to any of the foregoing, in each case that is either (A) organized or incorporated under the laws of the United States or having its principal place of business in the United States (such entity, a "legal entity") or (B) in which the direct or indirect owners thereof are responsible for the liabilities of such entity and one or more of such owners is a U.S. Person.
- Any individual account (discretionary or not) where the beneficial owner is a U.S. Person.
- Any commodity pool, pooled account or collective investment vehicle (whether or not it is organized or incorporated in the United States) of which a majority ownership is held, directly or indirectly, by a U.S. Person or U.S. Persons.
- Any commodity pool, pooled account or collective investment vehicle, the operator of which would be required to register as a commodity pool operator under the CEA.

- A pension plan for the employees, officers or principals of a legal entity with its principal place of business inside of the United States.
- An estate or trust, the income of which is subject to the United States income tax, regardless of source.

For this purpose, the term “United States” means the United States, its states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands and any other territories or possessions of the United States government, its agencies or instrumentalities.

By the proposed definition, a foreign branch or agency of a U.S. Person will be a U.S. Person as a branch or agency is not a separate legal entity from that U.S. Person. However, a foreign subsidiary or affiliate of a U.S. Person will not be a U.S. Person, even when the U.S. Person guarantees the obligations of such foreign subsidiary or affiliate.

### **APPLICATION OF REGISTRATION THRESHOLDS TO CROSS-BORDER ACTIVITIES**

The CFTC rules for the definitions of “Swap Dealer” and “Major Swap Participant” (the “Entity Definition Rules”) contain numerical thresholds for swap activities of a person, which if exceeded will trigger registration requirements for such person with the CFTC as either a Swap Dealer or a Major Swap Participant. Once registered, Swap Dealers and Major Swap Participants will be subject to a number of substantive regulatory requirements with respect to their swap activities and transactions. In this Proposed Interpretative Guidance, the CFTC sets out the general manner in which those numerical thresholds and related substantive regulatory requirements will apply to the activities of non-U.S. Persons and to foreign branches, agencies, subsidiaries and affiliates of U.S. Persons and U.S. branches of non-U.S. Persons.

#### **Swap dealer registration thresholds**

**General Principle.** In determining whether a non-U.S. Person’s swap dealing activity exceeds a *de minimis* threshold for Swap Dealer registration, the CFTC proposes that such non-U.S. Person must take into account the aggregate notional value of (i) all of its swap dealing transactions with counterparties that are U.S. Persons and (ii) all of its swap dealing transactions with counterparties that are not U.S. Persons when its own obligations are guaranteed by a U.S. Person.

For this, when the non-U.S. Person’s swap counterparty is the foreign branch of a registered U.S. Swap Dealer, the foreign branch is not deemed to be a U.S. Person; therefore, the notional value of those swaps does not need to be included by the non-U.S. Person for its *de minimis* calculation. The rationale for this exclusion is to permit a non-U.S. Person to engage in swap

dealing with foreign branches of U.S. Swap Dealers, outside the United States, without having to register with the CFTC.

As stated above, if a non-U.S. Person's swap obligations are guaranteed by a U.S. Person, all of such non-U.S. Person's swap dealing (including swap dealing with any non-U.S. Person and any swap dealing with foreign branches of a registered U.S. Swap Dealer) must be taken into account for the de minimis calculation for that non-U.S. Person. The CFTC explains that the swap dealing activities of a non-U.S. Person facing other non-U.S. Persons will still constitute a "direct and significant connection with activities in, or effect on, commerce of the United States" when the dealing non-U.S. Person's swap obligations are ultimately guaranteed by a U.S. Person; therefore, those swaps must be included.

**Application of the Rule for Aggregation of Swaps for Non-U.S. Swap Dealers.** The Entity Definition Rules require the aggregation of swap dealing activities of all affiliates under common control in determining whether a de minimis threshold is exceeded. If such threshold is exceeded when aggregated, all affiliates engaged in swap dealing will be required to register as Swap Dealers.

In applying the aggregation rule to the general principle, the CFTC proposes that a non-U.S. Person must include the aggregate notional value of:

- Swap dealing transactions between it (or any of its non-U.S. affiliates under common control) and a U.S. Person (other than foreign branches of U.S. Persons that are registered Swap Dealers), and
- Swap dealing transactions (or any swap dealing transactions of its non-U.S. affiliates under common control) where its own obligations or its non-U.S. affiliates' obligations thereunder are guaranteed by U.S. Persons.

However, the swap dealing transactions of U.S. affiliates under common control are not included in determining whether non-U.S. Persons under common control meet the definition of Swap Dealer on an aggregate basis. On the other hand, when applying the aggregation rule to U.S. Persons under common control, the swap dealing transactions of non-U.S. affiliates under common control must be taken into account.

### **Major swap participant registration thresholds**

**General Principle.** In determining whether a non-U.S. person's swap positions exceed one of the thresholds for Major Swap Participant registration, the CFTC proposes that a non-U.S. Person must take into account its swap positions where its counterparties are U.S. Persons.

**Application of the Rule for Swap Guarantees for Non-U.S. Major Swap Participants.** With respect to the definition of “Major Swap Participant,” the Entity Definition Rules require that a person’s swap positions are attributed to a guarantor (such as a parent entity or other affiliate) to the extent that counterparties to those positions have recourse to the guarantor (unless that person is otherwise already subject to prudential capital regulation) in order to determine which entity has exceeded the relevant threshold for Major Swap Participant registration. Therefore, with respect to the Major Swap Participant determination a non-U.S. Person does not need to include any of its swap position that is guaranteed by a U.S. Person. However, if a non-U.S. Person guarantees the swap obligations of another non-U.S. Person facing a U.S. Person, then those swap positions should be attributed to the non-U.S. Person that is acting as a guarantor.

In applying the swap guarantee attribution rule to the general principle, the CFTC proposes that, in determining its Major Swap Participant status, a non-U.S. Person must include the aggregate notional value of:

- Any swap between it and a U.S. Person; however, it can exclude its swaps where its own obligations are guaranteed by a U.S. Person as such swaps will generally be attributed to that U.S. Person, and
- Any swap between another non-U.S. Person and a U.S. Person, where it guarantees the obligations of the non-U.S. Person thereunder.

## **REGISTRATION OF NON-U.S. PERSONS**

**Foreign Branches and Agencies of U.S. Swap Dealers.** As a foreign branch or agency of a U.S. Person does not have a separate legal existence from the U.S. Person, the CFTC proposes to apply its regulations to the swap dealing activities of the U.S. Person on an entity-wide basis, including all the activities of its foreign branches and agencies. The U.S. Person itself will have to register as a Swap Dealer but can delegate certain duties and regulatory obligations to the foreign branches and agencies.

**Foreign Affiliates or Subsidiaries of U.S. Persons.** For a U.S. Person that operates a “central booking” system, in which one or more of its foreign branches, affiliates or subsidiaries negotiate swaps but such swaps are ultimately booked (directly or indirectly) with the U.S. Person, the CFTC proposes that the U.S. Person acting as the “central booking” entity register as Swap Dealer, regardless of whether the swaps were directly booked (i.e., entered into) by the U.S. Person or were indirectly transferred to the U.S. Person (e.g., by way of a back-to-back swap or similar arrangement). In addition, such affiliate or subsidiary may need to register as a Swap Dealer if it meets the registration requirements on its own.

**U.S. Branches, Agencies, Affiliates or Subsidiaries of Non-U.S. Persons.** Consistent with the interpretation applicable to the swap activities of foreign branches, agencies, subsidiaries and affiliates of U.S. Persons, the CFTC proposes the same approach with respect to non-U.S. Persons with U.S. branches, agencies, subsidiaries or affiliates. Therefore, if a non-U.S. Person directly or indirectly acts as a “central booking” entity for swaps solicited or negotiated by such branch, subsidiary or affiliate, the non-U.S. Person must determine whether it is required to register as Swap Dealer in the same manner as a U.S. Person in a similar situation. In addition, such subsidiary or affiliate must register as Swap Dealer if it independently meets the registration requirements. The Proposed Interpretive Guidance is silent on whether a U.S. branch of a non-U.S. Person must register as Swap Dealer. Since a branch is not treated as a separate entity under the Proposed Interpretive Guidance, a non-U.S. Person will be required to register as Swap Dealer if such non-U.S. Person meets the registration requirements based on its swap dealing activities, regardless of whether such non-U.S. Person engages in swap dealing through a U.S. branch.

## **APPLICATION OF SUBSTANTIVE REQUIREMENTS TO NON-U.S. PERSONS**

### **Entity-Level Requirements and Transaction-Level Requirements**

The CFTC proposes to separate the substantive swap rules into two main categories: Entity-Level Requirements, which apply to all Swap Dealers and Major Swap Participants, across all their swap transactions (without distinction as to the counterparty or location of a swap), and Transaction-Level Requirements, which apply to specific swap transactions. We have attached to this memorandum the Appendices provided by the CFTC in connection with the Proposed Interpretive Guidance, which summarize the application of the substantive swap regulations to various non-U.S. Persons.

**Entity-Level Requirements.** The Entity-Level Requirements are (i) capital adequacy, (ii) chief compliance officer, (iii) risk management, (iv) swap data recordkeeping, (v) swap data reporting and (vi) physical commodity swaps reporting (*i.e.*, large swap trader reporting).

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

**Application of the Entity-Level and Transaction-Level Requirements to Non-U.S. Swap Dealers and Non-U.S. Major Swap Participants**

**Entity-Level Requirements.** The CFTC proposes that non-U.S. Swap Dealers and non-U.S. Major Swap Participants must comply with all of the Entity-Level Requirements. However, acknowledging the principles of international comity, it also proposes to permit substituted compliance with comparable and comprehensive foreign regulations in certain circumstances.

For swap data reporting, the CFTC specifies that non-U.S. Swap Dealers and non-U.S. Major Swap Participants must report all of their swaps to a registered swap data repository (“SDR”) and non-U.S. Swap Dealers must comply with large swap trading reporting requirements. However, the CFTC clarifies that with respect to swaps between the non-U.S. Swap Dealer or non-U.S. Major Swap Participants and other non-U.S. Persons, substituted compliance with home regulations will be permitted as long as the CFTC has direct access to the swap data that is stored at the foreign trade repository.

**Transaction-Level Requirements.** The CFTC proposes requiring non-U.S. Swap Dealers and non-U.S. Major Swap Participants to comply with the Transaction-Level Requirements for all of their swaps with U.S. Persons, except for foreign branches of U.S. Persons. In most cases, substituting home regulations in the foregoing situation will not be permitted.

In case the swap counterparty of a non-U.S. Swap Dealer or non-U.S. Major Swap Participant is not a U.S. Person, but the performance of such counterparty is guaranteed by a U.S. Person, then the CFTC will require the compliance with the requirements related to clearing, swap processing, margin (and segregation), portfolio reconciliation and compression and trade execution requirements, but substituted compliance with home regulations may be permitted.

The CFTC expresses a concern where a non-U.S. Swap Dealer or non-U.S. Major Swap Participant enters into a swap with a non-U.S. Person that acts as a conduit for a U.S. Person, where such U.S. Person does not guarantee the obligations of such non-U.S. counterparty or where a U.S. Swap Dealer or Major Swap participant enters into a swap with its foreign affiliate of subsidiary which then enters into a swap with a non-U.S. counterparty in a jurisdiction that is unregulated or lacks comparable transactional regulations. Therefore, the CFTC proposes to apply the Transaction-Level Requirements to swaps in which (i) a non-U.S. counterparty is majority-owned, directly or indirectly, by a U.S. Person, (ii) the non-U.S. counterparty regularly enters into swaps with one or more other U.S. affiliates or subsidiaries of the U.S. Person and (iii) the financials of such non-U.S. counterparty are included in the consolidated financial statements of the U.S. Person. The CFTC will permit substituted compliance for such Transaction-Level Requirements with respect to swaps between a non-U.S. Swap Dealer or non-U.S. Major Swap Participant and such affiliate conduit.

Consistent with the guiding principle of the Proposed Interpretative Guidance, the CFTC will not require the compliance by non-U.S. Swap Dealer and non-U.S. Major Swap Participants with the Transaction-Level Requirements with respect to swaps with a non-U.S. Person that is not guaranteed by a U.S. Person. Further, the CFTC will not require the compliance with external business conduct rules with respect to swaps with non-U.S. Persons as counterparties, regardless of whether the performance of such counterparties are guaranteed by a U.S. Person.

**Application of Substantive Requirements to Foreign Branches, Agencies, Affiliates and Subsidiaries of U.S. Swap Dealers**

**Foreign Branches and Agencies.** The CFTC proposes that the U.S. Person with a foreign branch or agency be legally responsible for all applicable entity-level and transaction-level requirements, irrespective of whether the counterparty is a U.S. Person or non-U.S. Person. However, the CFTC proposes that substituted compliance with Transaction-Level Requirements will be permitted for swaps between the foreign branch of a U.S. Person and a counterparty that is a non-U.S. Person (whether or not the obligations of such non-U.S. Person is guaranteed by a U.S. Person). Further, in the event that foreign regulations applicable to certain foreign branches are deemed not to be comparable, the CFTC nevertheless proposes to permit, subject to certain recordkeeping requirements (including those needed for verification of this exception), substituted compliance for swap activities of the foreign branches as long as the aggregate notional value (determined in U.S. dollars on a quarterly basis) of the swaps of all foreign branches in the relevant country does not exceed 5% of all the swaps of the U.S. Swap Dealer.

**Foreign Affiliates and Subsidiaries.** With respect to foreign affiliates and subsidiaries, the CFTC proposes that the application of substantive requirements will depend on where the swaps are booked and whether the affiliate or subsidiary facing a foreign counterparty engages in swap activities that will require it to register as a Swap Dealer. If the swaps are directly booked in the U.S. Swap Dealer and the foreign affiliate or subsidiary engages in swap dealing activities that independently require registration as a Swap Dealer, the U.S. Swap Dealer must comply with all requirements, and the foreign affiliate or subsidiary must register as a Swap Dealer and also comply with all applicable requirements of the CEA in its swap dealing activities (in which case substituted compliance is permitted for the Non-U.S. Swap Dealer). In this situation where both the U.S. Person and its foreign affiliate or subsidiary are required to register as Swap Dealers, they both will be responsible for satisfying the requirements of the CEA; if one party fails to comply with a requirement, both parties will be held responsible.

If a counterparty facing foreign affiliate or subsidiary is acting merely as a disclosed agent and does not meet the registration requirements, then only the U.S. Person must register as a Swap Dealer as long as the agency relationship is properly documented and the U.S. Person remains primarily responsible for the actions of its affiliate or subsidiary.



If a counterparty facing foreign affiliate or subsidiary is required to be registered as a Swap Dealer with the CFTC and its swaps are not centrally booked with the related U.S. Person, the CFTC proposes to treat the foreign affiliate or subsidiary the same manner as any other non-U.S. Swap Dealer. With respect to SDR reporting, the CFTC proposes to require compliance, but permit substituted compliance as long as the CFTC has direct access to swap data stored in the foreign data repository.

**Substituted Compliance: Process for Comparability Determination.** The CFTC intends to use its past experience exempting foreign brokers from futures commission merchants registration requirements based on “comparability” findings as the basis of the comparability determination for swap regulations, with appropriate adjustments to reflect the heightened requirements of the Dodd-Frank Act. The CFTC will thus examine the local regulatory requirements and use an outcome-based approach to determine whether those requirements are comparable with the CEA.

The CFTC will take into accounts all relevant factors, including the scope and objectives of the foreign regulatory requirements, the comprehensiveness of such requirements, the comprehensiveness of the foreign regulator’s supervisory compliance program and the foreign regulator’s authority to support and enforce its oversight of the non-U.S. Swap Dealer or non-U.S. Major Swap Participant and other swap market participants transacting in the relevant country. The CFTC may find that the local regulations are comparable only in some areas of the applicable CEA swap regulations, in which case, the CFTC proposes to recognize substituted compliance in those areas. For the purpose of this determination, “comparable” does not mean identical; rather, the CFTC will determine, using broad discretion, if the local regulations are comparable to the requirements supported and enforced by the CFTC in a way that will meet the same objectives.

The application for substituted compliance can be made by any non-U.S. Person, whether separately or in groups from the same jurisdiction. The CFTC expects such request to be made at the same time as the non-U.S. Person submits its application to become a Swap Dealer or a Major Swap Participant. Currently, the CFTC anticipates that it would work with the National Futures Association to develop the relevant submission procedures. In addition, a foreign regulator can also submit an application on behalf of the entities that are subject to its jurisdiction.

For a non-U.S. Person to apply for substituted compliance, it would be required—at a minimum—to state the factual basis for such application and include with specificity all applicable foreign legislation, rules and policies. Further, the CFTC will expect to receive notifications from such non-U.S. Person regarding any material changes to information

previously submitted in support of a comparability finding. The CFTC also expects that it would enter into an appropriate memorandum of understanding or similar arrangement with the relevant foreign supervisor with respect to situations in which substituted compliance has been granted. The CFTC contemplates that the memorandum of understanding will provide for ongoing coordination of supervisory activities by both the foreign regulator and the CFTC, including giving the CFTC access to information, onsite visits and ability to receive certain future notifications. Generally, prior comparability determinations by the CFTC will be used to facilitate reviews of subsequent determinations in the same jurisdiction. In the event of future changes to the regulations in the CEA, the CFTC will initiate discussions with the affected Swap Dealers, Major Swap Participants and their regulators to address any potential discrepancy.

### **TRANSACTIONS INVOLVING NON-SWAP DEALERS AND NON-MAJOR SWAP PARTICIPANTS**

Clearing, trade execution, real-time swap data public reporting, large trader reporting and swap data reporting requirements apply to all swap participants, without regard to their status as Swap Dealer, Major Swap Participant or neither. As the CFTC believes that the swap activities of U.S. Persons outside the United States could have a direct and significant connection with activities in, or effect on, U.S. commerce, it proposes the following:

- Clearing, trade execution and real-time public reporting requirements will apply to any swap where one of the counterparties is a U.S. Person (irrespective of the location of the transaction), without permitting substituted compliance.
- Non-U.S. clearing members will be required to report all reportable positions under Part 20 rules and traders with reportable positions would be subject to the relevant recordkeeping obligations, without permitting substituted compliance.
- Substituted compliance will be permitted with respect to transactions between a U.S. Person and a non-U.S. Person that are otherwise subject to the swap data repository reporting and swap data recordkeeping requirements as long as the CFTC has direct access to the swap data for these transactions that is stored at the foreign trade repository.

**PROPOSED EXEMPTIVE ORDER—DEFERRED COMPLIANCE**

The CFTC also issued a proposed exemptive order to defer the compliance dates for certain Entity-Level and Transaction-Level Requirements with respect to non-U.S. Persons. Non-U.S. Swap Dealers, non-U.S. Major Swap Participants and non-U.S. branches of U.S. Swap Dealers and U.S. Major Swap Participants may delay the compliance with certain of such requirements until the 12 months following the publication of the proposed order, and U.S. Swap Dealers and U.S. Major Swap Participants (other than with respect to their non-U.S. branches) may delay the compliance date until January 1, 2013. The proposed order, however, does not permit the delay of the registration with the CFTC as a Swap Dealer or Major Swap Participant.

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**APPENDICES**

above which would provide a framework for regulatory coordination where two or more jurisdictions have authority over a swap.

### **Request for Comment**

Q31. Please provide comments regarding all aspects of the Commission's interpretation of CEA section 2(i) with respect to the proposed application of the Transaction-Level Requirements. The Commission is particularly interested in commenters' views on the impact on U.S. persons as a result of the proposed application of the Dodd-Frank Act's trading requirements.

Q32. What, if any, competitive or economic effects on U.S. commerce, including U.S. persons, should the Commission consider when interpreting CEA section 2(i)? What, if any, competitive or economic effects on non-U.S. persons should the Commission consider when interpreting CEA section 2(i)?

## **APPENDIX A**

### **ENTITY-LEVEL REQUIREMENTS**

The Entity-Level Requirements relate to the management of risks to a swap dealer or MSP as a whole. Accordingly, these requirements apply on a firm-wide basis, inclusive of all swaps and irrespective of whether the counterparty is a U.S. person (or not) or where the transactions are executed.

**Capital:** CEA section 4s(e) directs the Commission to set capital requirements for swap dealers and MSPs that are not subject to the capital requirements of prudential regulators (*i.e.*, non-bank swap entities). The Commission has proposed rule, §23.101, which would apply FCM capital requirements if the nonbank swap dealer or MSP is also registered as an FCM, and would apply other capital requirements for those that are not also FCMs. Certain of these non-FCM, nonbank swap entities would be required to meet capital requirements established by the Federal Reserve Board; specifically, SIFIs and nonbank subsidiaries of U.S. bank holding companies.<sup>140</sup>

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<sup>140</sup> SIFIs that are not FCMs would be exempt from the Commission's capital requirements, and would comply instead with Federal Reserve Board requirements applicable to SIFIs, while nonbank (and non-FCM) subsidiaries of U.S. bank holding companies would calculate their Commission capital requirement using the same methodology specified in Federal Reserve Board regulations applicable to the bank holding company, as if the subsidiary itself were a bank holding company.

**Chief Compliance Officer:** CEA Section 4s(k) requires that each swap dealer and MSP to designate a chief compliance officer (“CCO”) and specify certain duties by the CCO. Pursuant to section 4s(k), the Commission adopted § 3.3, which requires swap dealers and MSPs to designate a CCO responsible for administering the firm’s compliance policies and procedures, reporting directly to the board of directors or a senior officer of the swap dealer, as well as preparing and filing (with the Commission) a certified report of compliance with the CEA.

**Risk Management:** CEA Section 4s(j) requires each swap dealer and MSP to establish internal policies and procedures designed to, among other things, address risk management, monitor compliance with position limits, prevent conflicts of interest, and promote diligent supervision, as well as maintain business continuity and disaster recovery programs. The Commission adopted implementing regulations (§§ 23.600, 23.601, 23.602, 23.603, 23.605, 23.606, and 23.607). The Commission also adopted: (A) § 23.609, which requires certain risk management procedures for swap dealers or MSPs that are clearing members of a DCO; and (B) §23.608, which prohibits swap dealers providing clearing services to customers from entering into agreements that would: (i) disclose the identity of a customer’s original executing counterparty; (ii) limit the number of counterparties a customer may trade with; (iii) impose counterparty-based position limits; (iv) impair a customer’s access to execution of a trade on terms that have a reasonable relationship to the best terms available; or (v) prevent compliance with specified time frames for acceptance of trades into clearing.

**Swap Data Recordkeeping:** CEA section 4s(f)(1)(B) requires swap dealers and MSPs to keep books and records for all activities related to their business. Section 4s(g)(1) requires swap dealers and MSPs to maintain trading records for each swap transaction and all related records, as well as a complete audit trail for comprehensive trade reconstructions. Pursuant to these provisions, the Commission adopted §§ 23.201 and 23.203, which require swap dealers and MSPs to keep records including complete transaction and position information for all swap activities, including documentation on which trade information is originally recorded. Swap dealers and MSPs also have to comply with Part 46 of the Commission’s regulations, which addresses the recordkeeping requirements for swaps entered into before the date of enactment of the Dodd-Frank Act (“pre-enactment swaps”) and data relating to swaps entered into on or after the date of enactment but prior to the part 45 compliance date (“transition swaps”).

**SDR Reporting:** CEA section 2(a)(13)(G) requires all swaps, whether cleared or uncleared, to be reported to a registered swap data repository (“SDR”). CEA section 21 requires SDRs to collect and maintain data related to swap transactions as prescribed by the Commission, and to make such data electronically available to regulators. Swap dealers and MSPs would be required to comply with Part 45 of the Commission’s regulations, which set forth the specific transaction data that reporting counterparties and registered entities must report to a registered SDR; and Part 46, which addresses the recordkeeping requirements for pre-enactment swaps and data relating to transition swaps.

**Physical Commodity Swaps Reporting (Large Trader Reporting):** CEA section 4t authorizes the Commission to establish a large trader reporting system for significant price discovery swaps, of which the economically equivalent swaps subject to part 20 reporting are a subset, and in order to implement the statutory mandate in CEA section 4a for the Commission to establish

position limits, as appropriate, for physical commodity swaps. The Commission published part 20 rules requiring swap dealers, among other entities, to submit routine position reports on certain physical commodity swaps and swaptions.

### ENTITY-LEVEL REQUIREMENTS

|  |                           |
|--|---------------------------|
| <b>US-Based Swap Dealer</b>  | Apply                     |
| <b>Foreign Branches/Agencies of US-Based Swap Dealer**</b>   | Apply                     |
| <b>Foreign Affiliates of US Person</b><br>- <b>Swaps Booked in US</b>  | Apply*                    |
| <b>Foreign Affiliate of US Person</b><br>- <b>The Affiliate is the Legal Counterparty But All Swaps <u>Guaranteed</u> by US Person</b>                                       | Substituted Compliance*** |
| <b>Foreign Affiliate of US Person</b><br>- <b>Swaps <u>Not</u> Booked in US (<i>i.e.</i>, Affiliate is Legal Counterparty); and Swaps <u>Not</u> Guaranteed by US Person</b> | Substituted Compliance    |
| <b>Non-US-Based Swap Dealer</b><br>- <b>Swaps neither Booked in US nor Guaranteed by US Person</b>   | Substituted Compliance    |

\*Where swaps are solicited or negotiated by a foreign affiliate of a U.S. person but directly booked in the U.S. person, the U.S. person must comply with all of the swap dealer duties and obligations related to the swaps, including registration, capital and related prudential requirements.

\*\*Both Entity-Level and Transaction-Level Requirements are the ultimate responsibilities of the U.S.-based swap dealer.

\*\*\*With respect to the SDR reporting requirement, the Commission may permit substituted compliance only if direct access to swap data is provided to the Commission

## APPENDIX B

### TRANSACTION-LEVEL REQUIREMENTS

The Transaction-Level Requirements cover a range of Dodd-Frank requirements: some of the requirements more directly address financial protection of swap dealers (or MSPs) and their counterparties; others address more directly market efficiency and/or price discovery. Further, some of the Transaction-Level Requirements can be classified as Entity-Level Requirements and applied on a firm-wide basis across all swap transactions or activities. Nevertheless, in the interest of comity principles, the Commission believes that the Transaction-Level Requirements may be applied on a transaction-by-transaction basis.

#### Category A: Risk Mitigation and Transparency

**Clearing and Swap Processing:** CEA section 2(h)(1) requires a swap to be submitted for clearing to a derivatives clearing organization (“DCO”) if the Commission has determined that the swap is required to be cleared, unless one of the parties to the swap is eligible for an exception under section 2(h)(7) from the clearing requirement and elects not to clear the swap. Finally, the Commission adopted § 23.506, which requires swap dealers and MSPs to submit swaps promptly for clearing and comply with § 23.610, which establishes certain standards for swap processing by swap dealers and MSPs that are clearing members of a DCO.

**Margin (and Segregation) Requirement for Uncleared Swap Transactions:** Section 4s(e) explicitly requires the adoption of rules establishing margin requirements for swap dealers and MSPs, and applies a bifurcated approach that requires each swap dealer and MSP for which there is a prudential regulator to meet the margin requirements established by the applicable prudential regulator, and each swap dealer and MSP for which there is no prudential regulator to comply with Commission's margin regulations. In contrast, the “segregation” requirements in 4s(1) don't use a bifurcated approach – all swap dealers and MSPs are subject to the Commission's rule regarding notice and third party custodians for margin collected for uncleared swaps.

**Mandatory Trade Execution:** CEA section 2(h)(8) provides that unless a non-financial end-user exemption applies, a swap that is subject to clearing requirement and made available to trade must be traded on a DCM or SEF.

**Swap Trading Relationship Documentation:** CEA Section 4s(i) requires each swap dealer and MSP to conform to commission standards for the timely and accurate confirmation, processing, netting documentation and valuation of swaps. Pursuant thereto the Commission has proposed § 23.504(a), which would require swap dealers and MSPs to “establish, maintain and enforce written policies and procedures” to ensure that the swap dealer or MSP executes written swap trading relationship documentation. Under proposed §§ 23.505(b)(1), 23.504 (b)(3), and 23.504(b)(4), the swap trading relationship documentation must include, among other things: all terms governing the trading relationship between the swap dealer and its counterparty; credit support arrangements; investment and rehypothecation terms for assets used as margin for



uncleared swaps and custodial arrangements.<sup>141</sup> Further, the swap trading relationship documentation requirement applies to all transactions with registered swap dealers and MSPs.

**Portfolio Reconciliation and Compression:** CEA section 4s(i) directs the Commission to prescribe regulations for the timely and accurate processing and netting of all swaps entered into by swap dealers and MSPs. Pursuant to CEA section 4s(i), the Commission proposed regulations (§§ 23.502 and 23.503), which would require swap dealers and MSPs to perform portfolio reconciliation and compression, respectively, for all swap transactions. Portfolio reconciliation is a post-execution risk management tool to ensure accurate confirmation of a swap's terms and to identify and resolve any discrepancies between counterparties regarding the valuation of the swap. Portfolio compression is a post-trade processing and netting mechanism that is intended to ensure timely accurate processing and netting of swaps. Proposed § 23.503(c) would require all swap dealers and MSPs to participate in bilateral compression exercises and/or multilateral portfolio compression exercises conducted by their SROs or DCOs of which they are members. Further, participation in multilateral portfolio compression exercises is mandatory for dealer to dealer trades.

**Real-Time Public Reporting:** CEA section 2(a)(13) directs the Commission to promulgate rules providing for the public availability of swap transaction data in real time basis. The Commission promulgated part 43 rules, which provides that all “publicly reportable swap transactions” must be reported and publicly disseminated.

**Trade Confirmation:** CEA section 4s(i) requires that each swap dealer and MSP must comply with the Commission's regulations prescribing timely and accurate confirmation of transactions. The Commission has proposed § 23.501, which requires, among other things, a timely and accurate confirmation of all swaps and life cycle events for existing swaps. In addition, proposed § 23.504(b)(2) requires a swap dealer's and MSP's swap trading relationship documentation to include all confirmations of swap transactions.

**Daily Trading Records:** Pursuant to section CEA 4s(g)(1), the Commission adopted § 23.202, which requires swap dealers and MSPs to maintain daily trading records, including records of trade information related to pre-execution, execution, and post-execution data that is needed to conduct a comprehensive and accurate trade reconstruction for each swap. The final rule also requires that records be kept of cash or forward transactions used to hedge, mitigate the risk of, or offset any swap held by the swap dealer or MSP.

### **Category B: Sales Practices**

**External Business Conduct Standards:** Pursuant to CEA section 4s(h), the Commission has adopted external business conduct rules, which establish business conduct standards governing the conduct of swap dealers and MSPs in dealing with their counterparties in entering into swaps

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<sup>141</sup> The requirements under section 4s(i) relating to trade confirmations is a Transaction-Level Requirement. Accordingly, proposed 17 CFR 23.504(b)(2), which requires a swap dealer's and MSP's swap trading relationship documentation to include all confirmations of swap transactions, will apply on a transaction-by-transaction basis.

### CATEGORY A

|  | <b>US Person</b> | <b>Non-US Person<br/>Guaranteed by<br/>US Person**</b> | <b>Non-US Person<br/>Not Guaranteed<br/>by US Person</b> |
|--|------------------|--|--|
| <b>US-Based Swap Dealer</b>  | Apply            | Apply  | Apply  |
| <b>Foreign Affiliate<br/>Swaps Booked in US*</b>   | Apply            | Apply  | Apply  |
| <b>Foreign Branches/Agencies<br/>of US-Based Swap Dealer</b>   | Apply            | Substituted<br>Compliance***                           | Substituted<br>Compliance***                             |
| <b>Foreign Affiliate of US Person</b><br>- The Affiliate is the<br>Legal Counterparty<br>But All Swaps<br>Guaranteed by US<br>Person   | Apply            | Substituted<br>Compliance                              | Do Not Apply   |
| <b>Foreign Affiliate of US Person</b><br>- Swaps <b>Not</b> Booked in<br>US ( <i>i.e.</i> , Affiliate is<br>Legal Counterparty);<br>and Swaps <b>Not</b><br>Guaranteed by US<br>Person | Apply            | Substituted<br>Compliance                              | Do Not Apply   |
| <b>Non-US-Based Swap Dealer</b><br>- Swaps neither Booked<br>in US nor Guaranteed<br>by US Person  | Apply            | Substituted<br>Compliance                              | Do Not Apply   |

\* Where swaps are solicited or negotiated by a foreign affiliate but directly booked in the U.S. person, the U.S. person must comply with all of the swap dealer duties and obligations, including all Transaction-Level Requirements. The foreign affiliate, if separately required to register as a swap dealer, must comply with those requirements applicable to its swap dealing activities.

\*\* The Transaction-Level Requirements apply to swaps in which: (i) a non-U.S. counterparty is majority-owned, directly or indirectly, by a U.S. person; (ii) the non-U.S. counterparty regularly enters into swaps with one or more U.S. affiliates or subsidiaries of the U.S. person; and (iii) the financials of such non-U.S. counterparty are included in the consolidated financial statements of the U.S. person.

\*\*\*Under limited circumstances, where there is not a comparable foreign regulatory regime, foreign branches and agencies of U.S. swap dealers may comply with the local transaction-level requirements rather than the Transaction-Level Requirements, subject to specified conditions.

\*\*\*\* The swap trading relationship documentation requirement applies to all transactions with registered swap dealers and MSPs.

\*\*\*\*\*Participation in multilateral portfolio compression exercises is mandatory for dealer to dealer trades.

### CATEGORY B

|  | <b>US Person</b> | <b>Non-US Person<br/>Guaranteed by<br/>US Person**</b> | <b>Non-US Person<br/>Not Guaranteed<br/>by US Person</b> |
|--|------------------|--|--|
| <b>US-Based Swap Dealer</b>  | Apply            | Apply  | Apply  |
| <b>Foreign Affiliate of US<br/>Person<br/>Swaps are Booked in US*</b>  | Apply            | Do Not Apply   | Do Not Apply   |
| <b>Foreign<br/>Branches/Agencies of US-<br/>Based Swap Dealer</b>  | Apply            | Do Not Apply   | Do Not Apply   |
| <b>Foreign Affiliate of US<br/>Person<br/>- The Affiliate is the<br/>Legal<br/>Counterparty But<br/>All Swaps<br/><u>Guaranteed</u> by US<br/>Person</b> | Apply            | Do Not Apply   | Do Not Apply   |

|   |       |              |              |
|---|-------|--------------|--------------|
| <b>Foreign Affiliate of US Person</b><br>- Swaps <b>Not Booked</b> in US ( <i>i.e.</i> , Affiliate is Legal Counterparty); and Swaps <b>Not Guaranteed</b> by US Person | Apply | Do Not Apply | Do Not Apply |
| <b>Non-US-Based Swap Dealer</b><br>- Swaps neither <b>Booked in US</b> nor <b>Guaranteed by US Person</b>   | Apply | Do Not Apply | Do Not Apply |

\*Where swaps are solicited or negotiated by an affiliate of a U.S. person but directly booked in the U.S. person, the U.S. person must comply with all of the swap dealer duties and obligations, including all Transaction-Level Requirements. The foreign affiliate, if separately required to register as a swap dealer, must comply with those requirements applicable to its swap dealing activities.

\*\* The Transaction-Level Requirements apply to swaps in which: (i) a non-U.S. counterparty is majority-owned, directly or indirectly, by a U.S. person; (ii) the non-U.S. counterparty regularly enters into swaps with one or more U.S. affiliates or subsidiaries of the U.S. person; and (iii) the financials of such non-U.S. counterparty are included in the consolidated financial statements of the U.S. person.

**All OTHER (NON-SWAP DEALER/MSP) MARKET PARTICIPANTS\***  
**APPENDIX C**

|  | US Person | Non-US Person <u>Guaranteed</u> by US Person | Non-US Person <u>Not Guaranteed</u> by US Person |
|--|-----------|--|--|
| US Person                                    | Apply     | Apply  | Apply  |
| Non-US Person <u>Guaranteed</u> by US Person | Apply     | Do Not Apply                                 | Do Not Apply                                     |

|  | <b>US Person</b> | <b>Non-US Person<br/>Guaranteed<br/>by US Person</b> | <b>Non-US Person<br/>Not Guaranteed<br/>by US Person</b> |
|--|------------------|--|--|
| <b>Non-US Person Not<br/>Guaranteed by US Person</b> | Apply            | Do Not Apply   | Do Not Apply   |

\* The relevant Dodd-Frank requirements are those relating to: clearing, trade execution, real-time public reporting, Large Trader Reporting, SDR reporting and swap data recordkeeping.

Issued in Washington, DC, on June 29, 2012, by the Commission.



David A. Stawick,  
Secretary of the Commission

**Appendices to Cross-Border Application of Certain Swaps Provisions of the  
Commodity Exchange Act—Commission Voting Summary and Statements of  
Commissioners**

**NOTE: The following appendices will not appear in the Code of Federal  
Regulations**

**Appendix 1- Commission Voting Summary**

**On this matter, Chairman Gensler and Commissioners Sommers, Chilton, O’Malia  
and Wetjen voted in the affirmative; no Commissioner voted in the negative.**

**Appendix 2- Statement of Chairman Gary Gensler**

I support the proposed guidance on the cross-border application of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd Frank Act). The Commission is not required to solicit public comment on interpretive guidance, but we are particularly interested in the public’s input and look forward to comments on the proposed guidance.