

CLIENT UPDATE

CFTC NO-ACTION RELIEF AND REQUEST FOR COMMENT FOR TRANSACTION-LEVEL REQUIREMENTS OF NON-US SWAP DEALERS

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On November 14, 2013, the Division of Swap Dealer and Intermediary Oversight (“DSIO”) of the Commodity Futures Trading Commission (the “CFTC”) issued Advisory 13-69 (the “Advisory”)¹ in response to inquiries from swap market participants as to whether a non-U.S. swap dealer (“SD”) must comply with the Transaction-Level Requirements set forth in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) and the CFTC’s regulations thereunder (the “Regulations”) when entering into a swap with a non-U.S. person if the swap is arranged, negotiated or executed by personnel or agents of the non-U.S. SD located in the United States.²

Subsequent to the issuance of the Advisory, certain non-U.S. SDs raised concerns regarding compliance with the Transaction-Level Requirements for swaps with non-U.S. persons that are not guaranteed affiliates³ or conduit affiliates⁴ of a U.S. person where the non-U.S. SD uses personnel or agents located in the United States to

¹ The Advisory is available at <http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/13-69.pdf>

² The term “U.S. person” has the meaning set forth in the CFTC’s Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45292 (July 26, 2013).

³ A “guaranteed affiliate” is defined as a non-U.S. person that is an affiliate of a U.S. person and that is guaranteed by a U.S. person.

⁴ A “conduit affiliate” is defined as an entity that functions as a conduit or vehicle for U.S. persons conducting swaps with third parties, as determined on the basis of a number of factors including the ownership of a non-U.S. person or vice versa, as well as common ownership by a third person.

arrange, negotiate or execute such swaps (“Covered Transactions”). In response to these concerns, on November 26, 2013, DSIO, along with the Division of Market Oversight and the Division of Clearing and Risk of the CFTC (collectively, the “Divisions”) issued a no-action letter (the “Original No-Action Letter”) granting temporary relief to non-U.S. SDs from certain Transaction-Level Requirements to allow them to organize their internal policies and procedures to come into compliance with such requirements when entering into Covered Transactions. This no-action relief was set to expire on January 14, 2014.

On January 3, 2014, the Divisions issued another no-action letter (the “Subsequent No-Action Letter”) extending this relief to September 15, 2014,⁵ as well as a separate request for public comment (“Request for Comment”) on the Advisory “in view of the complex legal and policy issues involved.”⁶ Comments on the Advisory must be received by the CFTC by March 10, 2014.

BACKGROUND

The CFTC’s guidance on the applicability of certain swap regulations to cross-border transactions (the “Cross-Border Guidance”)⁷ distinguishes between two types of Title VII swaps regulations applicable to SDs:

- “Entity-Level Requirements,” including capital adequacy, chief compliance officer, risk management, swap data recordkeeping, swap data repository reporting and large trader reporting, which apply to the firm as a whole; and
- “Transaction-Level Requirements,” including clearing and swap processing, mandatory trade execution, swap trading relationship documentation, portfolio reconciliation and compression, real-time public reporting, trade confirmation, daily trading records, margin and segregation requirements for uncleared swaps and external business conduct requirements, which apply to the individual swap transaction or trading relationship.

Generally, the Cross-Border Guidance provides that substituted compliance⁸ should be available for the Transaction-Level Requirements with respect to swaps between a non-

⁵ Both no-action letters are available at <http://www.cftc.gov/PressRoom/PressReleases/pr6818-14>

⁶ The Request for Comment is available at <http://www.gpo.gov/fdsys/pkg/FR-2014-01-08/pdf/2014-00080.pdf>

⁷ See the CFTC’s Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45292 (July 26, 2013) and our client memorandum on that guidance, dated July 24, 2013, available at <http://www.debevoise.com/newseventspubs/publications/detail.aspx?id=e39c6856-07fa-4600-867d-ed23701a1ef0>

⁸ Substituted compliance refers to the circumstances under which the CFTC will permit a non-U.S. SD to comply with “comparable and comprehensive” regulatory requirements of its home jurisdiction with respect to certain of its swaps and swap-related activities in lieu of complying with the Commodity Exchange Act and the Regulations.

U.S. SD and a non-U.S. person, or should not apply at all, depending on whether such non-U.S. person is a guaranteed affiliate or conduit affiliate of a U.S. person.

ADVISORY

The Advisory provides that for swaps between a non-U.S. SD and a non-U.S. counterparty, the Transaction-Level Requirements either do not apply or, in some cases, may be subject to substituted compliance, if the activities of the non-U.S. SD take place outside the United States.

On the other hand, the Advisory states that as persons regularly arranging, negotiating or executing swaps for or on behalf of an SD are performing core, front-office activities of that SD's dealing business, a non-U.S. SD (whether or not an affiliate of a U.S. person) regularly using personnel or agents located in the U.S. to arrange, negotiate or execute a swap with a non-U.S. person generally will be required to comply with the Transaction-Level Requirements.

Further, the Advisory states that this policy also applies to a swap between a non-U.S. SD and a non-U.S. person booked in a non-U.S. branch of the non-U.S. SD, so long as the non-U.S. SD uses personnel or agents located in the U.S. to arrange, negotiate or execute the swap. In this regard, the policy set forth in the Advisory is stricter than that set forth in the Cross-Border Guidance, which states in footnote 513 that a U.S. branch of a non-U.S. SD is subject to Transaction-Level Requirements, without substituted compliance available, but is silent as to the applicability of such requirements to a non-U.S. branch of a non-U.S. SD.

NO-ACTION RELIEF

In response to concerns raised by non-U.S. SDs regarding compliance with the Transaction-Level Requirements when entering into Covered Transactions, the Original No-Action Letter provided that, until January 14, 2014, the Divisions would not recommend that the CFTC take an enforcement action against a non-U.S. SD (whether or not an affiliate of a U.S. person) for failure to comply with:

- Any applicable "Transaction-Level Requirement" with respect to a Covered Transaction if the Covered Transaction is not with a non-U.S. SD; and
- If the Covered Transaction is with a non-U.S. SD, any Transaction-Level Requirement other than (1) the multilateral portfolio compression requirements under Regulation 23.503 and (2) the swap trading relationship requirements under Regulation 23.504.

The Subsequent No-Action Letter extends this relief to September 15, 2014.

For purposes of the no-action relief, the term “Transaction-Level Requirements” is limited to the following: clearing and swap processing (Regulation 23.506 and Part 50), documentation requirements applicable to entities relying on the end-user exemption from mandatory clearing (Regulation 23.505), clearing member acceptance for clearing (Regulation 23.610), swap trading relationship documentation (Regulation 23.504), portfolio reconciliation and compression (Regulations 23.502 and 23.503), real-time public reporting (Regulation 23.205 and Part 43), trade confirmation (Regulation 23.501), daily trading records (Regulation 23.202) and the business conduct standards for SDs and major swap participants with counterparties (Regulations 23.400 to 23.451).⁹

REQUEST FOR COMMENT

The Request for Comment solicits comments regarding all aspects of the Advisory, including but not limited to the following points:

- Whether the CFTC should adopt the Advisory as its policy, in whole or in part.
- Whether Transaction-Level Requirements should apply to Covered Transactions with non-U.S. persons who are not guaranteed or conduit affiliates.¹⁰
- Whether the treatment of swaps with non-U.S. counterparties should vary depending on the nature of the SD (i.e., whether it is a guaranteed or conduit affiliate).
- To the extent a non-U.S. SD must comply with the Transaction-Level Requirements when entering a Covered Transaction, whether the non-U.S. SD should be able to rely on a substituted compliance program for purposes of complying with the relevant requirements and, if so, whether substituted compliance should be available for all Transaction-Level Requirements or only specific requirements (and, if the latter, which requirements).¹¹
- The meaning of the term “regularly” in the phrase “persons regularly arranging, negotiating, or executing swaps for or on behalf of an SD” and whether such persons

⁹ While the Cross-Border Guidance includes additional Title VII requirements within the scope of the term “Transaction-Level Requirements” (including margin and segregation requirements for uncleared swaps, mandatory trade execution and the external business conduct rules other than Regulation 23.451), these requirements are not included in the definition of “Transaction-Level Requirements” set forth in the no-action letters. The CFTC notes in the no-action letters that (1) it has not yet finalized regulations regarding margin for uncleared swaps, (2) compliance with its Regulations regarding segregation of uncleared swaps is not yet required and (3) it has not yet determined that any swap is “available to trade” such that a trade execution requirement applies to the swap.

¹⁰ The CFTC notes that such comments should include a detailed analysis of any such view and its effect on other aspects of the CFTC’s cross-border policy.

¹¹ The CFTC also requests comment on whether the response to this question would be different depending on the nature of the counterparty (i.e., whether the counterparty is a guaranteed affiliate or conduit affiliate).

are performing core, front-office activities of that SD's swap dealing business (and if not, what specific activities would constitute "core, front-office" activities).¹²

- The scope and degree of "arranging, negotiating, or executing" swaps as used in this context.

The Request for Comment states that if a comment relates to one of the specific points noted above, the commenter should identify the point by number¹³ and provide a detailed rationale supporting the response.

The Request for Comment was approved by a majority vote, with Commissioner O'Malia voting in the negative. In addition to his objection to the Request for Comment, Commissioner O'Malia also issued a dissenting statement, seeking additional comments on the extent to which Covered Transactions fall within the CFTC's jurisdiction, among other topics.

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Please do not hesitate to contact us with any questions.

January 9, 2014

¹² The CFTC also requests comment on which characteristics or factors distinguish a "core, front-office" activity from other activities.

¹³ For ease of reference, this client memorandum numbers the specific requests for comment using the same number scheme set forth in the Advisory.