

CFTC Issues Final Cross-Border Swap Exemptive Order

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Introduction

On December 21, 2012, the CFTC issued a final exemptive order relating to the application of certain swap-related provisions of the U.S. Commodity Exchange Act to swap activities outside the United States (the “**Exemptive Order**”).¹ The Exemptive Order adopts a number of provisions in the CFTC’s proposed cross-border exemptive order (the “**Proposed Order**”),² and also addresses some, but not all, of the topics covered in the CFTC’s proposed cross-border guidance (the “**Proposed Guidance**”).³

Among other provisions, the final Exemptive Order:

- adopts a new temporary definition of “U.S. person”;
- clarifies what swap activity a non-U.S. person should include in determining whether it must register as a swap dealer (“**SD**”) or major swap participant (“**MSP**”) and, in doing so, provides significant temporary relief from the requirement that non-U.S. persons must aggregate the U.S. swap dealing activity of their non-U.S. affiliates;
- allows non-U.S. SDs and MSPs to delay compliance with most of the CFTC’s entity-level swap requirements;
- allows non-U.S. SDs and MSPs and non-U.S. branches of U.S. SDs and MSPs to delay compliance with the CFTC’s transaction-level swap requirements with non-U.S. persons and, in some cases, with non-U.S. branches of U.S. persons; and
- includes a request for public comment on several additional proposals that the CFTC will consider in connection with its further deliberations concerning the Proposed Guidance.

The Exemptive Order will expire on July 12, 2013.

¹ CFTC Final Exemptive Order Regarding Compliance with Certain Swap Regulations; Further Proposed Guidance, available [here](#).

² CFTC Proposed Exemptive Order Regarding Compliance with Certain Swap Regulations, available [here](#).

³ CFTC Proposed Interpretive Guidance and Policy Statement Regarding Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, available [here](#).

“U.S. Person” Phase-In Definition

The Exemptive Order defines a “U.S. person” as any person that is:

- (i) a natural person who is a resident of the United States;
- (ii) a 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 (a) organized or incorporated under the laws of a state or other jurisdiction in the United States; or (b) effective as of April 1, 2013 for all such entities other than funds or collective investment vehicles, having its principal place of business in the United States;
- (iii) a pension plan for the employees, officers or principals of a legal entity described in (ii) above, unless the pension plan is primarily for foreign employees of such entity;
- (iv) an estate of a decedent who was a resident of the United States at the time of death, or a 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 the administration of the trust; or
- (v) an 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 person described in (i) through (iv) above.

U.S. Person Phase-In Definition

For purposes of the Exemptive Order, the CFTC has adopted a temporary, “phase-in” definition of “U.S. person” for market participants to use in determining registration obligations and the application of substantive swap-related requirements. This phase-in definition is substantially similar to one used in the CFTC’s October 12, 2012 no-action letter regarding the calculation of SD and MSP registration thresholds (the “**Threshold No-Action Letter**”).⁴ Specifically, for the purposes of the Exemptive Order, “U.S. person” is defined in the sidebar.

While the Exemptive Order’s phase-in definition of U.S. person is substantially similar to that used in the Threshold No-Action Letter, there are several differences, including the following:

- the phase-in definition modifies the treatment of pension plans for foreign employees of U.S. companies;
- the phase-in definition revises the prong of the U.S. person definition related to estates and trusts to remove consideration of U.S. tax treatment; and
- the phase-in definition includes an entity whose “principal place of business” is in the United States. This was included in the Proposed Guidance, but was removed from the definition used in the Threshold No-Action Letter. However, unlike the Proposed Guidance definition, the phase-in definition does not look to the principal place of business of a fund or other collective investment vehicle. Also, the “principal place of business” prong will not become part of the phase-in definition until April 1, 2013.

An entity may choose to use this phase-in definition or the one in the Threshold No-Action Letter until December 31, 2012. After that date, the phase-in definition in the Exemptive Order must be used.

A person may reasonably rely on a counterparty’s representation in determining whether the counterparty is a U.S. person, provided that the person must conduct reasonable due diligence on its counterparties and cannot ignore red flags.

The CFTC emphasizes that the phase-in definition is not permanent and that any final definition of U.S. person may be different.

⁴ CFTC No-Action Letter 12-22, Time-Limited No-Action Relief: Swaps Only With Certain Persons to be Included in Calculation of Aggregate Gross Notional Amount for Purposes of Swap Dealer De Minimis Exception and Calculation of Whether a Person is a Major Swap Participant, available [here](#).

SD and MSP Registration Calculations

In light of the first SD registration deadline on December 31, 2012, and the fact that the CFTC has not yet finalized the Proposed Guidance, the Exemptive Order provides the following criteria for how a non-U.S. person should determine whether it must register as an SD or MSP:

- A non-U.S. person does not need to include in its own SD *de minimis* or MSP threshold calculation:
 - any swap where its counterparty is a non-U.S. person, whether or not the potential registrant's swap obligations are guaranteed by a U.S. person; or
 - any swap where its counterparty is a non-U.S. branch of a U.S. person that (i) is registered as an SD or (ii) represents that it intends, by March 31, 2013, to register as an SD.⁵
- For purposes of aggregating its swap dealing activity with that of its affiliates to determine whether it exceeds the SD *de minimis* threshold:
 - a non-U.S. person is not required to include swaps entered into by its non-U.S. affiliates with non-U.S. person counterparties, even if those non-U.S. person affiliates are guaranteed by U.S. persons;
 - a non-U.S. person that is engaged in swap dealing activities with U.S. persons as of December 21, 2012 is not required to aggregate its swap dealing activity with that of its U.S. person affiliates; and
 - in an important departure from previous guidance that will decrease the number of non-U.S. entities required to register during the pendency of the Exemptive Order, a non-U.S. person that is engaged in swap dealing activities with U.S. persons as of December 21, 2012 and that has an affiliate that is a registered SD is not required to aggregate its swap dealing positions with those of any non-U.S. affiliate that is either engaged in swap dealing with U.S. persons as of December 21, 2012 or is a registered SD.

⁵ The representation need not be obtained prior to execution of the swap.

Entity-Level and Transaction-Level Requirements

Entity-level requirements:

- capital adequacy
- chief compliance officer
- internal business conduct (including risk management, position limits monitoring, conflicts of interest, supervision, business continuity and clearing member risk management)
- swap data recordkeeping
- swap data reporting to SDRs
- large trader reporting (physical commodity swaps reporting)

Transaction-level requirements:

- clearing and swap processing
- margining and segregation for uncleared swaps
- trade execution
- swap trading relationship documentation
- portfolio reconciliation and compression
- real-time public reporting
- trade confirmation
- daily trading records
- external business conduct standards

Application of Swap-Related Requirements

The Exemptive Order provides that, until July 12, 2013:

- non-U.S. SDs and MSPs may delay compliance with entity-level requirements (as listed in the sidebar) in effect as of December 21, 2012;
 - however, a non-U.S. SD or MSP may delay compliance with swap data and large trader reporting requirements only for transactions with non-U.S. person counterparties, and only if the non-U.S. SD or MSP is 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;
- non-U.S. SDs and MSPs may delay compliance with transaction-level requirements (as defined in the sidebar) for swaps with non-U.S. person counterparties, and potentially non-U.S. branches of U.S. SDs and MSPs,⁶ provided such non-U.S. SDs and MSPs comply with home country regulations; and
- non-U.S. branches of a U.S. SD or MSP may delay compliance with transaction-level requirements with non-U.S. person counterparties and other such non-U.S. branches, provided such non-U.S. branches comply with regulatory requirements in the foreign location of the branch.

SDs and MSPs must timely register with the CFTC to rely on this temporary exemptive relief. The Exemptive Order does not, however, require SDs and MSPs to submit a “compliance plan” to the CFTC within 60 days of applying for registration as an SD or MSP in order to benefit from the relief, which had been a condition for relief under the Proposed Order.

The CFTC states that relief from transaction-level requirements is available for swap transactions for which both counterparties are non-U.S. branches of U.S. SDs and MSPs only where:

- (i) the personnel negotiating and agreeing to the terms of the swap are located in the jurisdiction of the non-U.S. branch;
- (ii) the documentation of the swap specifies that the counterparty or “office” of the U.S. person is the non-U.S. branch; and

⁶ The language of the Exemptive Order itself is not clear as to whether a non-U.S. person that is an SD or MSP is entitled to this relief for transactions with non-U.S. branches of U.S. SDs and MSPs. The CFTC notes in the release, however, that “the Commission clarifies that relief from the Transaction-Level Requirements is available to a swap between a foreign branch of a U.S. registrant and a non-U.S. SD. That is, for purposes of this relief, the non-U.S. SD may treat the foreign branch as a non-U.S. person.”

- (iii) the swap is entered into by the non-U.S. branch in its normal course of business.

The CFTC states that it is considering other requirements that a swap transaction must meet to be considered a transaction of a non-U.S. branch rather than the U.S. person of which that branch is a part.

The Exemptive Order provides no relief to non-SD/MSP registrants for the entity-level and transaction-level requirements that apply to them, such as reporting, recordkeeping and clearing.

CFTC Enforcement Intentions

The CFTC has issued 31 no-action letters, interim final rules and other documents related to the implementation of swap-related requirements during the month of December. Many of these releases address implementation challenges that stem from upcoming compliance deadlines. To alleviate market concern regarding compliance with swap-related requirements, the Exemptive Order release includes a statement regarding the CFTC's intent to allow market participants time to work through these issues. Specifically, the CFTC states that it:

does not intend to bring an enforcement action against an SD or MSP for failing to fully comply with applicable Dodd-Frank requirements prior to July 12, 2013, provided that there is a practical or technical impediment to compliance that results in an inability to comply with relevant compliance deadlines, or uncertainty in interpreting, particular Dodd-Frank requirement(s) and the SD or MSP is acting reasonably and in good faith to fully comply with the applicable Dodd-Frank requirements, which would include, at a minimum

- (i) material progress toward timely implementation and compliance;
- (ii) identification of any implementation or interpretive issue as soon as reasonably possible;
- (iii) timely elevation of such issue(s) to the SD's or MSP's senior management for consideration and resolution; and
- (iv) timely consultation with other industry participants and the Commission as necessary to seek resolution of any such issue(s).

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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Additional Proposed Guidance

The CFTC continues to consider permanent guidance on the cross-border impact of the Commodity Exchange Act's swap provisions. As part of this effort, the Exemptive Order includes the following additional proposals on which the CFTC seeks comment:

- an alternative SD *de minimis* aggregation rule for non-U.S. persons, under which a non-U.S. person would be required to aggregate its swap dealing activities with both U.S. and non-U.S. person affiliates, but would not be required to aggregate with its non-U.S. affiliates that are registered SDs;
- an alternative to the prong of the "U.S. person" definition in the Proposed Guidance that relates to responsibility by a U.S. person for the debts of an entity, which would clarify that it is meant to include situations of unlimited liability by a U.S. person rather than a guarantee by a U.S. person; and
- an alternative to the prong of the "U.S. person" definition in the Proposed Guidance that relates to majority-owned commodity pools, pooled accounts or collective investment vehicles.

Comments on this additional proposed guidance are due 30 days after the Exemptive Order is published in the Federal Register, which is expected shortly.

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