

# ClientAlert

## Capital Markets—Derivatives

August 2013

### CFTC Approves Final Interpretative Guidance With Respect to the Cross-Border Application of Certain Swap Provisions of the Commodity Exchange Act

#### Introduction

On July 12, 2013, the Commodity Futures Trading Commission (the “CFTC” or the “Commission”) approved final interpretative guidance (the “Final Guidance”)<sup>1</sup> regarding the cross-border application of certain swap provisions of the Commodity Exchange Act (the “CEA”). In order to aid in the transition to the new swaps regulatory regime set forth in the Final Guidance, on the same day, the Commission adopted an accompanying final exemptive order (the “Final Order”), which provides time-limited relief to non-US swap dealers and non-US major swap participants and foreign branches of US swap dealers and US major swap participants from certain swap provisions of the CEA. The Final Order should be considered in conjunction with the Final Guidance. We have discussed the Final Order in a separate Client Alert.<sup>2</sup>

Section 722(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) amended the CEA by adding Section 2(i), which provides that the swap provisions of the CEA do not apply to activities outside the United States unless those activities “have a direct and significant connection with activities in, or effect on, commerce of the United States” or contravene such rules or regulations as the Commission 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].<sup>3</sup> Section 2(i) therefore gives the CFTC express authority over activities outside the United States that have a direct and significant connection with activities in, or effect on, commerce in the United States. In its interpretation of the scope of Section 2(i) the CFTC looked to the Foreign Trade Antitrust Improvements Act of 1982, which provides the standard for the cross-border application of the Sherman Antitrust Act to conduct that has a “direct, substantial, and reasonably foreseeable effect” on US commerce. In its analysis the CFTC concluded that Section 2(i) applies to activities outside the United States that have either: “(1) a direct and significant effect on US commerce; or, in the alternative, (2) have a direct and significant connection with activities in US commerce, and through such connection present the type of risks to the US financial system and markets that Title VII directed the Commission to address.”<sup>4</sup>



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<sup>1</sup> Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 FR 45292 (July 26, 2013).

<sup>2</sup> For a further discussion, please refer to our Client Alert on the final exemptive order issued by the CFTC on July 12, 2013.

<sup>3</sup> 7 USC. § 2(i).

<sup>4</sup> 78 FR at 45300.

The Final Guidance is a statement of the Commission's general policy regarding cross-border swap activities. It allows for flexibility in its application in various situations while considering all relevant facts and circumstances. This statement, with certain modifications and clarifications, finalizes the Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act (the "Proposed Guidance")<sup>5</sup> and the Further Proposed Guidance Regarding Compliance With Certain Swap Regulations (the "Further Proposed Guidance")<sup>6</sup> published by the Commission on July 12, 2012 and January 7, 2013, respectively.

The Final Guidance addresses several important topics: (i) the final definition of the term "US person," including the treatment of foreign branches of US swap dealers and major swap participants, guaranteed affiliates, and conduit affiliates; (ii) the determinations of whether a non-US person is engaged in more than a *de minimis* level of swap dealing or holds swap positions above any of the major swap participant thresholds; (iii) compliance obligations, including substituted compliance by non-US persons, foreign branches of US swap dealers and major swap participants, with Entity-Level Requirements and Transaction-Level Requirements (as defined below).

## Definition of US Person

In order to determine whether entities will be subject to compliance with the CEA and the CFTC's regulations concerning swaps transactions, it is necessary to first determine if one or both of the counterparties is a US person. The following final definition of a US person applies only for purposes of the swap regulations under the CEA, as amended by Title VII of the Dodd-Frank Act.

The final definition of US person is as follows:

The term "US person" generally includes, but is not limited to:

- (i) any natural person who is a resident of the United States;
- (ii) any estate of a decedent who was a resident of the United States at the time of death;
- (iii) 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 an entity described in prongs (iv) or (v), below) (a "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;

- (iv) any pension plan for the employees, officers or principals of a legal entity described in prong (iii), unless the pension plan is primarily for foreign employees of such entity;
- (v) 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 the administration of the trust;
- (vi) any commodity pool, pooled account, investment fund, or other collective investment vehicle that is not described in prong (iii) and that is majority-owned by one or more persons described in prong (i), (ii), (iii), (iv), or (v), except any commodity pool, pooled account, investment fund, or other collective investment vehicle that is publicly offered only to non-US persons and not offered to US persons;
- (vii) any legal entity (other than a limited liability company, limited liability partnership or similar entity where all of the owners of the entity have limited liability) that is directly or indirectly majority-owned by one or more persons described in prong (i), (ii), (iii), (iv), or (v) and in which such person(s) bears unlimited responsibility for the obligations and liabilities of the legal entity; and
- (viii) 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 person described in prong (i), (ii), (iii), (iv), (v), (vi), or (vii).

The definition of US person in the Final Guidance is largely territorial-based and includes persons whose activities outside the United States meet the "direct and significant" jurisdictional nexus. The CFTC's definition is broader in scope than the one proposed by the Securities and Exchange Commission (the "SEC").<sup>7</sup> However, the SEC also includes transactions "conducted within the United States"<sup>8</sup> within the scope of its jurisdiction; as a result, a security-based swap (and the parties thereto) would be subject to regulation based on conduct in the United States, expanding the sweep of the SEC's cross-border regulatory purview.

<sup>5</sup> Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 FR 41214 (July 12, 2012).

<sup>6</sup> Further Proposed Guidance Regarding Compliance With Certain Swap Regulations, 78 FR 909 (Jan. 7, 2013).

<sup>7</sup> See Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, 78 FR 30968 (May 23, 2013) (the "SEC Cross-Border Proposal"). The SEC Cross-Border Proposal's definition of US person is defined as "A) any natural person resident in the United States; B) any partnership, corporation, trust or legal person organized or incorporated under the laws of the United States or having its principal place of business in the United States; and C) any account (whether discretionary or non-discretionary) of a US person." 78 FR at 31207.

<sup>8</sup> The SEC Cross-Border Proposal considers a transaction "conducted within the United States" when it is solicited, negotiated, executed or booked within the United States. *Id.*

**Principal Place of Business Test**

In the Final Guidance, the CFTC clarified its interpretation of “principal place of business” under prong (iii), which includes those entities that are organized outside the United States, but have the center of direction, control and coordination of their business activities in the United States. The Commission based its interpretation of the “principal place of business” test on Supreme Court precedent that describes a corporation’s principal place of business as the “place where the corporation’s high level officers direct, control, and coordinate the corporation’s activities,” and as the corporation’s headquarters or “nerve center” and not simply an office where the corporation holds its board meetings.<sup>9</sup>

The revised definition of US person in the Final Guidance captures collective investment vehicles, including offshore hedge funds, that have their principal place of business in the United States, or that are majority-owned by US persons. The Commission noted that the relevant senior personnel are not the directors or officers of the legal entities that comprise the investment vehicle, but rather the senior personnel responsible for (i) the formation and promotion of the collective investment vehicle or (ii) the implementation of the vehicle’s investment strategy, depending on the facts and circumstances that are relevant to determining the center of direction, control and coordination of the vehicle.<sup>10</sup> The Commission further clarified that it does not consider day-to-day administrative activities such as operating the vehicle’s bank account, issuing payment instructions, providing net asset calculations, calculating fees, receiving and processing subscriptions, preparing accounts, maintaining the shareholder register, arranging payments of redemption proceeds, coordinating communications with shareholders and overseeing anti-money laundering compliance as relevant in the determination of the location of a collective investment vehicle.<sup>11</sup>

**Funds Majority-Owned by US Persons**

Prong (vi) now provides that any commodity pool, pooled account, investment fund or other collective investment vehicle that is majority-owned by US persons would be deemed a US person irrespective of whether the fund is incorporated or organized in the United States. For purposes of this prong, “majority-owned” means the beneficial ownership of more than 50 percent of the equity or voting interests in the collective investment vehicle. In determining whether the collective vehicle is majority-owned by US persons, a collective investment vehicle should (i) determine whether its direct beneficial owners are US persons<sup>12</sup> and (ii) “look-through” the beneficial ownership of any other legal entity invested in the collective investment vehicle that is controlled by or under common control with the collective investment vehicle.<sup>13</sup> In response to comments highlighting the practical difficulties in identifying majority-owners, the Commission has eliminated the reference to “indirect” majority ownership, which had been included in the Further Proposed Guidance. The Commission noted that collective investment vehicles that are publicly offered exclusively to non-US persons generally will not fall within any of the prongs of the definition of US person.

**Entities Directly or Indirectly Majority-Owned by US Persons**

Prong (vii) adopts the alternative version proposed in the Further Proposed Guidance. It covers entities that are directly or indirectly majority-owned by US persons. The Commission intends to specifically avoid capturing those legal entities that have negligible US ownership interests. The “look-through” aspect of the analysis for determining US person ownership captures the situation where the structure of an entity is such that the US owners bear unlimited liability for the entity’s obligations and liabilities. Under this prong, entities in other jurisdictions that are similar to limited liability corporations or limited liability partnerships in which none of the owners of

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<sup>9</sup> 78 FR at 45309.

<sup>10</sup> However, legal entities do not become US persons solely by retaining an asset management firm located in the United States if such legal entities are not within any prong of the term “US person.” The Commission also noted that consideration of whether an employee is located in the United States will be considered without regard to employment status.

<sup>11</sup> 78 FR at 45311.

<sup>12</sup> US persons refer to the first five prongs of the definition: (i) any natural person who is a resident of the United States; (ii) any estate of a decedent who was a resident of the United States at the time of death; (iii) 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 an entity described in prongs (iv) or (v), below) (a “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; (iv) any pension plan for the employees, officers or principals of a legal entity described in prong (iii), unless the pension plan is primarily for foreign employees of such entity; (v) 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 the administration of the trust.

<sup>13</sup> The Commission noted in the Final Guidance that where a collective investment vehicle is owned in part by an unrelated investor collective investment vehicle, the collective investment vehicle need not “look-through” the unrelated investor entity, but may reasonably rely on written representations from the unrelated investor entity regarding whether it is a US person.

**Capital Markets—Derivatives**

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such entities bear unlimited liability for the entity's obligations, and liabilities would be excluded. Rather than requiring all the US persons who are majority-owners to bear unlimited responsibility, the entity is a US person if any of the US persons who are direct or indirect majority-owners bears unlimited responsibility for the obligations and liabilities of the entity. The Commission clarified that it does not intend for prong (vii) to capture legal entities organized or domiciled in a foreign jurisdiction but whose swaps are guaranteed by a US person. While the Commission is concerned with the risks that flow to a US guarantor from its guarantee, the Commission does not view guarantees as an assumption of unlimited liability.

**Foreign Branch of a US Person**

A foreign branch of a US person is itself a US person for purposes of the US person definition. As stated in the Proposed Guidance, a foreign branch does not have a separate legal identity from its parent entity. Branches are neither separately incorporated nor capitalized, and foreign branches share the same rights and obligations as the parent entity. For registration purposes, if a foreign branch of a US person engages in more than a *de minimis* amount of swap dealing activity or exceeds the threshold of a major swap participant, the US person must register, and the registration would encompass the foreign branch. However, for purposes of aggregation, the swap transactions of a foreign branch of a US person are treated differently. These differences are discussed below. The Final Guidance is silent on whether the US branch of a non-US swap dealer or major swap participant is then not a US person for registration purposes; however, the same analysis should apply in the reverse.

**Due Diligence**

The Commission imposes a general due diligence obligation in determining whether a counterparty is a US person. In making this determination a party may reasonably rely on its counterparty's written representation. In this respect, the Commission adopts a similar approach to the one used in the external business conduct standards. A party cannot rely on a written representation if it has information that would cause a reasonable person to question its accuracy. In other words, a party cannot ignore "red flags" when relying on such representations to satisfy its due diligence obligations. In addition, a party should review the written representations on a periodic basis to ensure that they remain appropriate for the intended purpose.

**Scope of Interpretation**

The Commission also continues to include the prefatory phrase "include, but not be limited to" in the "US person" definition as it is used in the Proposed Guidance. As a result, there may be situations where a person not fully described in the definition is appropriately treated as a US person for purposes of the Final Guidance. In making these determinations, the Commission will balance relevant facts and circumstances when evaluating the US person status of an entity, including:

- Strength of the connections between the person's swap-related activities and US commerce;
- Extent to which such activities are conducted in the United States;
- Importance to the United States of regulating the person's swap-related activities;
- Likelihood that including the person within the interpretation of "US person" could lead to regulatory conflicts; and
- Considerations of international comity.

**Swap Dealer *De Minimis* Calculation and Major Swap Participant Thresholds**

An entity is required to register as a swap dealer or major swap participant when the entity's swap dealing activities exceed the *de minimis* threshold of dealing activity for swap dealers or when the entity exceeds the swap activity threshold for major swap participants.

**Swap Dealers**

For purposes of determining if a US person is required to register as a swap dealer ("SD"), it is necessary to include all swap dealing activity, whether with US or non-US counterparties. In addition, a Guaranteed or Conduit Affiliate (as defined below under the heading "Guaranteed Affiliate and Conduit Affiliate") must also count all swap dealing activity, whether with US or non-US counterparties.

However, a non-US person (that is not a Guaranteed or Conduit Affiliate) is not required to include in the determination's count swaps transactions with other non-US persons and need only count swaps transactions with i) US persons; and ii) subject to certain exceptions specified below, Guaranteed Affiliates, but does not need to include swaps with Conduit Affiliates. A non-US person (that is not a Guaranteed or Conduit Affiliate) may also exclude swaps with (a) foreign branches of US SDs; (b) a Guaranteed Affiliate that is an SD; c) a Guaranteed Affiliate

**Capital Markets—Derivatives**

that is not an SD and itself engages in *de minimis* swap dealing activity and is affiliated with an SD; and d) a Guaranteed Affiliate that is, or is guaranteed by, a non-financial entity.<sup>14</sup>

In addition, a non-US person that is not a Guaranteed or Conduit Affiliate may exclude any swaps that are entered into anonymously on a registered designated contract market ("DCM"), swap execution facility ("SEF") or foreign board of trade ("FBOT"),<sup>15</sup> and such swaps are cleared. Furthermore, a non-US person that is not a Guaranteed or Conduit Affiliate clears a swap through a DCO, the resulting novated swap need not be counted for purposes of the *de minimis* threshold.

**Major Swap Participant**

Similar to the swap dealer determination, for purposes of determining if a US person is required to register as a major swap participant ("MSP"), it is necessary to include all swaps activity, whether with US or non-US counterparties; a Guaranteed or Conduit Affiliate must also count all swaps activity, whether with US or non-US counterparties, provided that a Guaranteed Affiliate would be subject to attribution rules.

A non-US person need only include: i) swaps entered into with a US person; ii) swaps entered into with a Guaranteed Affiliate (but if the swap obligations of the potential non-US MSP are guaranteed by a US person, then the swap is attributed to the US person guarantor and is not included in the non-US person's MSP determination; and iii) any swap position between another person (US or non-US) and a US person or a Guaranteed Affiliate, where the potential non-US MSP guarantees the obligation of the other person thereunder.

In addition, a non-US person that is a financial entity<sup>16</sup> (that is not a Guaranteed Affiliate) does not need to include swap transactions with i) foreign branches of US SDs; or ii) Guaranteed Affiliates that are SDs, so long as the swap is either cleared or the swap requires the foreign branch or Guaranteed Affiliate to collect daily variation margin, with no threshold amount, on its swaps with the non-US person.

A non-US person that is not a financial entity and not a Guaranteed Affiliate need not include swaps with foreign branches of a US SD or a Guaranteed Affiliate that is an SD.

**Aggregation**

Under the Final Guidance, for purposes of calculating the *de minimis* threshold, both US persons and non-US persons must include swap dealing activities of all of its affiliates under common control<sup>17</sup> (referred to herein as an "affiliated group") (whether US or non-US), except for swaps of an affiliate SD (whether US or non-US). When the affiliated group nears the *de minimis* threshold in the aggregate, it would have to register one or more affiliates (inside or outside the United States) as an SD. Registered SD's swaps would then be excluded from the calculation so that the relevant swap dealing activity of the unregistered affiliates remains below the threshold. As a result, an affiliated group is allowed to engage in unregistered swap dealing activity up to the *de minimis* level for the entire group. This aggregation requirement is more expansive than the requirement in the Proposed Guidance that allowed a non-US person to exclude swap dealing activity of its US affiliates.

**Guaranteed Affiliate and Conduit Affiliate**

A "Guaranteed Affiliate" refers to a non-US person that is affiliated with and guaranteed by a US person.

The Commission takes the view that any guarantee with recourse regardless of whether it is "full recourse," is price forming and an integral part of a guaranteed swap. In addition to traditional guarantees, it also views other formal agreements or arrangements in which one party commits to provide a financial backstop or funding against potential losses that may be incurred by the other party, either from specific contracts or more generally<sup>18</sup> as guarantees for purposes of Section 2(i) of the CEA. The CFTC will focus on the substance, rather than the form of the arrangement, in determining whether or not a financial arrangement constitutes a "guarantee" for purposes of the term Guaranteed Affiliate.

A non-US conduit affiliate of a US person, a "Conduit Affiliate," is determined based on a number of factors. Such factors include whether:

- (i) the non-US person is a majority-owned affiliate of a US person;
- (ii) the non-US person is controlling, controlled by or under common control with the US person;

<sup>14</sup> See CEA Section 2(h)(7)(C) for a definition of "financial entity."

<sup>15</sup> A registered FBOT means an FBOT that is registered with the Commission pursuant to Part 48 of the CFTC regulations in order to permit direct access to the FBOT's order entry and trade matching system from within the United States.

<sup>16</sup> See CEA Section 2(h)(7)(C) for a definition of "financial entity."

<sup>17</sup> See Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 FR 30596, 30631 n.437 (May 23, 2012), which defines 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."

<sup>18</sup> E.g., keepwells and liquidity puts, certain types of indemnity agreements, master trust agreements, liability or loss transfer or sharing agreements, and any other explicit financial support arrangements. Note that this is not an exhaustive list.



- (iii) the financial results of the non-US person are included in the consolidated financial statements of the US person; and
- (iv) the non-US person, in the regular course of business, engages in swaps with non-US third-parties for the purpose of hedging or mitigating risks faced by, or to take positions on behalf of, its US affiliates, and enters into offsetting swaps or other arrangements with its US affiliates in order to transfer the risks and benefits of such swaps with third-parties to its US affiliates.

This list of factors is not considered exhaustive, and the CFTC may consider additional relevant factors depending on the facts and circumstances.

Conduit Affiliates act as vehicles or conduits in effecting swap transactions with third parties on behalf of US persons but generally do not include SDs or affiliates of SDs. The CFTC explained that Conduit Affiliates are used by large global companies to centralize their hedging or risk-management in one or more affiliates.

A Guaranteed Affiliate and Conduit Affiliate are collectively referred to herein as “Guaranteed or Conduit Affiliate.”

### Foreign Branch

As a result of the Commission's view that branches are neither separately incorporated nor separately capitalized and the rights and obligations of a branch are the rights and obligations of its principal entity (and vice versa), a foreign branch of a US person is itself a US person under the Final Guidance as in the Proposed Guidance. Likewise, foreign branches of US persons are not recognized separately from their US principal for purposes of registration. That is, if the foreign branch were to be an SD/MSP, the US person would be required to register, and the registration would encompass the foreign branch. However, foreign branches are in some instances treated similarly to non-US persons for purposes of certain Transaction-Level Requirements and SD/MSP determination for non-US persons dealing with foreign branches.

Under the Final Guidance, a “foreign branch” is any “foreign branch” of a US bank that is (i) subject to Regulation K<sup>19</sup> or the Federal Deposit Insurance Corporation (the “FDIC”) International

Banking Regulation,<sup>20</sup> or otherwise designated as a “foreign branch” by the US bank’s primary regulator, (ii) 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 (iii) subject to substantive regulation in banking or financing in the jurisdiction where it is located. In addition to the foregoing characteristics, the Commission will consider other relevant facts and circumstances in determining whether a foreign office of a US bank is a “foreign branch” of a US bank. However, a foreign branch of a US bank would not include an affiliate of a US bank that is incorporated or organized as a separate legal entity.

In respect of whether a swap should be considered as being with the foreign branch of a US bank, the Commission provides that if all of the following factors are present, generally, the swap should be considered to be with the foreign branch of a US bank:

- (i) the employees negotiating and agreeing to the terms of the swap (or, if the swap is executed electronically, managing the execution of the swap), other than employees with functions that are solely clerical or ministerial, are located in such foreign branch or in another foreign branch of the US bank;
- (ii) the foreign branch or another foreign branch is the office through which the US bank makes and receives payments and deliveries under the swap on behalf of the foreign branch pursuant to a master netting or similar trading agreement, and the documentation of the swap specifies that the office for the US bank is such foreign branch;
- (iii) the swap is entered into by such foreign branch in its normal course of business;
- (iv) the swap is treated as a swap of the foreign branch for tax purposes; and
- (v) the swap is reflected in the local accounts of the foreign branch.

However, if the material terms of the swap are negotiated or agreed to by employees of the US bank located in the United States, the Commission believes that generally, the swap should be considered with the US principal bank, rather than the foreign branch.

<sup>19</sup> Under Regulation K issued by the Board of Governors of the Federal Reserve, a “foreign branch” is defined 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.” 17 CFR §211.2(k).

<sup>20</sup> Under the FDIC International Banking Regulation, a “foreign branch” is defined as “an office or place of business located outside the United States, its territories, Puerto Rico, Guam, American Samoa, the Trust Territory of the Pacific Islands, or the Virgin Islands, at which banking operations are conducted, but does not include a representative office.” 12 CFR §347.102(j).

**Capital Markets—Derivatives****Table A—Summary of Dealing Determination**

Table A summarizes which dealing swaps a non-US person or US person must consider in determining whether it is engaged in more than a *de minimis* level of swap dealing.

Parties Making the SD Determination	Counterparty	SD Calculation
<b>Non-US person (that is not a Guaranteed or Conduit Affiliate)</b>	Non-US person	Exclude.
	Guaranteed Affiliate	Include (other than as listed below).  Exclude swaps with: i) Guaranteed Affiliates that are SDs; ii) Guaranteed Affiliates that are not SDs but which are affiliated with an SD and where the Guaranteed Affiliate itself engages in <i>de minimis</i> swap dealing activity; iii) Guaranteed Affiliates that are guaranteed by a non-financial entity; and iv) swaps entered into anonymously on a registered DCM, SEF, or FBOT and cleared.
	Conduit Affiliate	Exclude.
	US person	Include (other than as listed below).  Exclude swaps with: i) foreign branches of a US SD; and ii) swaps entered into anonymously on a registered DCM, SEF, or FBOT and cleared.
<b>Non-US person (that is a Guaranteed or Conduit Affiliate)</b>	Non-US person	Include.
	US person	Include.
<b>US person</b>	Non-US person	Include, even if the swaps are conducted by foreign branches.
	US person	Include, even if the swaps are conducted by foreign branches.

**Table B—Summary of MSP Determination**

Table B summarizes which swaps a non-US person and US person must consider in determining whether it holds swap positions in excess of any of the MSP thresholds.

Entity	Counterparty	MSP Calculation
<b>Non-US person</b>	US person	Include all swaps.
	Guaranteed Affiliate	Include all swaps <i>other than</i> swaps of the potential non-US MSP that are guaranteed by a US person.
	N/A (where potential MSP is the guarantor)	Include all swaps where the potential non-US MSP guarantees the obligations of a swap between another (US or non-US) person and a US person or Guaranteed Affiliate.
	That is a Guaranteed or Conduit Affiliate	US or non-US person Include all swaps, <i>except where</i> the non-US person is facing a Guaranteed Affiliate.
	That is not a Guaranteed Affiliate and is a financial entity	Foreign branches of US SDs or Guaranteed Affiliates that are SDs Exclude, <i>provided</i> the swap is either cleared, or the documentation of the swap requires the foreign branch or Guaranteed Affiliate to, and the SD actually does, collect daily variation margin, with no threshold amount, on its swaps with the non-US person.
	That is not a Guaranteed Affiliate and is not a financial entity	Foreign branches of US SDs or Guaranteed Affiliates that are SDs Exclude.
<b>US person (including a Guaranteed or Conduit Affiliate)</b>	US or non-US person	Include all swaps.

## Entity-Level and Transaction-Level Requirements

Under the regulatory framework established by Title VII of the Dodd-Frank Act, registered SDs and MSPs must comply with risk management, internal and external business conduct, and reporting and recordkeeping requirements, among other things. As in the Proposed Guidance, the Final Guidance divides these into two types of requirements—entity-level and transaction-level. In certain circumstances, the Commission would permit a non-US SD/MSP or a foreign branch of a US SD to comply with these requirements through a substituted compliance regime.

### Substituted Compliance

Substituted compliance would be permitted if the CFTC determines that the foreign requirements are comparable to and as comprehensive as the corresponding requirements under the CEA and the CFTC's regulations on a requirement-by-requirement basis using an outcomes-based approach. This means that a non-US SD/MSP, a foreign branch of a US SD, and a non-US non-registrant<sup>21</sup> that is a Guaranteed or Conduit Affiliate may be permitted to comply with the regulations in its home jurisdiction (or in the case of foreign branches of a bank, the foreign location of the branch) to the extent that the comparability/comprehensiveness standard is met. However, these entities would be required to comply with the relevant CEA statutory requirements and CFTC regulations where the Commission determines that comparable and comprehensive regulation in the home jurisdiction is lacking. Entities that are eligible for substituted compliance as well as foreign regulators may apply for substituted compliance treatment. The process of comparability determination remains largely the same as outlined in the Proposed Guidance.

Substituted compliance will be available to all entities in a jurisdiction where a comparability determination has been made. The CFTC expects to enter into a memorandum of understanding or other arrangement with the relevant foreign supervisor regarding information sharing and cooperation in the context of supervision. The CFTC will reevaluate each of its comparability determinations every four years.

Of particular note, the Commission acknowledges in the Final Guidance that its regulations may be in conflict with the blocking, privacy and secrecy laws of other jurisdictions. Where a real conflict of laws exists, registrants and foreign regulators are strongly encouraged to consult with the CFTC's staff.

## Entity-Level Requirements

The entity-level requirements include:

- (i) capital adequacy;
- (ii) chief compliance officer;
- (iii) risk management;
- (iv) swap data recordkeeping;
- (v) swap data repository reporting ("SDR Reporting"); and
- (vi) physical commodity large swaps trader reporting ("Large Trader Reporting").

The Final Guidance subdivides the Entity-Level Requirements into two subcategories. The first subcategory includes capital adequacy, chief compliance officer, risk management, and swap data recordkeeping (the "First Category"). The second subcategory includes SDR Reporting, certain aspects of swap data recordkeeping relating to complaints and marketing and sales materials, and Large Trader Reporting (the "Second Category" and the First Category and the Second Category, the "Entity-Level Requirements").

### US SDs and MSPs

Unsurprisingly, the Commission requires US SDs and MSPs to comply with all the Entity Level Requirements (First Category and Second Category) regardless of the type of counterparty—no substituted compliance allowed. This is based upon the CFTC's strong interest in regulating the swap activities that occur within the United States.

Foreign branches and agencies of US SDs/MSPs are part of the US SD/MSP, and therefore the US SD/MSP is responsible for compliance with the Entity Level Requirements. With respect to non-US affiliates and subsidiaries of US SDs/MSPs where the affiliate or subsidiary independently meets the SD/MSP definition, both the US SD/MSP and the non-US SD/MSP would be required to comply.

### Non-US SDs and MSPs

Non-US SDs/MSPs (including foreign affiliates of a US person independently required to register as such) are expected to comply with Entity-Level Requirements. Substituted compliance may be available depending on whether the particular requirement is a First Category or Second Category requirement, and for Second Category requirements on whether the counterparty is a US person or not. The Commission would allow a non-US SD/MSP transacting with a non-US counterparty to comply with the Entity-Level Requirements of the First Category through substituted compliance.

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<sup>21</sup> A non-US person that is not an SD/MSP. Discussed under the heading "Non-Registrants."



**Capital Markets—Derivatives**

In order to increase efficiencies and decrease burdens on corporate groups, the Commission will consider permitting Guaranteed Affiliates in a corporate group under common control that do not enter into swaps with US persons to comply with Entity-Level Requirements by establishing consolidated policies, procedures, governance structures, reporting lines, operational units and systems.

With respect to the Second Category requirements, the Commission allows non-US SDs/MSPs to comply with SDR Reporting through substituted compliance where the swap counterparty is a non-US person that is not a Guaranteed or Conduit Affiliate, so long as the Commission has direct access (including electronic access) to the relevant swap data that is stored at the foreign trade repository. The Commission will also allow substituted compliance with swap data recordkeeping related to complaints and marketing and sales materials where the counterparty is a US person. Substituted compliance for Large Trader Reporting is not allowed.

**Table C—Summary of Application of the Entity-Level Requirements**

Table C summarizes application of the Entity-Level Requirements<sup>22</sup> to SDs/MSPs and foreign branches of SDs/MSPs.

Entity	Counterparty	Compliance/Substituted Compliance
<b>US SD/MSP (including an affiliate of a non-US person)</b>	US person/ non-US person	First Category: Apply.  Second Category: Apply.  (Substituted Compliance not available)
<b>Foreign branch of a US SD/MSP</b>		

Entity	Counterparty	Compliance/Substituted Compliance
<b>Non-US SD/MSP (including foreign affiliates of a US person)</b>	US person	First Category: Substituted Compliance.  Second Category: Apply (Substituted Compliance not available).
	Non-US person	First Category: Substituted Compliance.  Second Category (SDR Reporting): Substituted Compliance for non-US counterparties that are not Guaranteed or Conduit Affiliates, provided that the Commission has direct access (including electronic access) to the relevant swap data that is stored at the foreign trade repository.  Second Category (swap data recordkeeping related to complaints and marketing and sales materials): Substituted Compliance.  Second Category (Large Trader Reporting): Apply (Substituted Compliance not available).

**Transaction-Level Requirements**

As the name suggests, transaction-level requirements are applied on a transaction-by-transaction basis ((i) through (ix) below, the “Transaction-Level Requirements”). The Transaction-Level Requirements include:

- (i) required 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.

<sup>22</sup> Entity-Level Requirements are divided into First Category and Second Category requirements. First Category includes (i) capital adequacy, (ii) chief compliance officer, (iii) risk management, and (iv) swap data recordkeeping (other than swap data recordkeeping relating to complaints and marketing and sales materials under CFTC Regulation 23.201(b)(3),(4)). Second Category includes (i) SDR Reporting, (ii) swap data recordkeeping related to complaints and marketing and sales materials under CFTC Regulation 23.201(b)(3),(4) and (iii) Large Trader Reporting. The CFTC has determined that no substituted compliance is available for Large Trader Reporting.

**Capital Markets—Derivatives**

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These requirements have also been classified into one of two subcategories: all of the Transaction-Level Requirements, except external business conduct standards, are in Category A; and the external business conduct standards are in Category B.

Below, we address the application of the Transaction-Level Requirements; however, we note that where a swap is executed anonymously between a non-US person (whether an SD or an MSP) and a US person (other than a foreign branch of a US SD/MSP) (i) on a registered DCM or SEF and cleared by a registered DCO or (ii) through a clearing organization that observes the Principles for Financial Market Infrastructures, the non-US person is deemed to have satisfied all of the Category A Transaction-Level Requirements<sup>23</sup> and the Category B Transaction-Level Requirements would not be applicable.

**Application of Category A Transaction-Level Requirements****US SDs/MSPs**

Where one of the counterparties to a swap is a US SD/MSP, the CFTC generally expects the parties to comply with Category A Transaction-Level Requirements without regard to whether the counterparty is a US person or a non-US person and substituted compliance is generally not available. This interpretation applies even when the US SD/MSP is an affiliate of a non-US person or when one of the counterparties is a foreign branch of a US SD/MSP.<sup>24</sup>

However, the CFTC permits substituted compliance where a swap is entered into between two foreign branches of a US SD/MSP or between a foreign branch of a US SD/MSP and a non-US person (regardless of whether the non-US person is a Guaranteed or Conduit Affiliate). The CFTC states in the Final Guidance that the interest in foreign regulators applying Transaction-Level Requirements to swaps executed in their jurisdiction, coupled with the fact that foreign branches of US SD/MSPs are subject to direct or indirect oversight by US regulators, weighs in favor of allowing substituted compliance.

**Five Percent Exception**

In a modification of the Proposed Guidance,<sup>25</sup> where a swap between a foreign branch of a US SD/MSP and a non-US person (that is not a Guaranteed or Conduit Affiliate) takes place in a jurisdiction, other than Australia, Canada, the European Union, Hong Kong, Japan or Switzerland,<sup>26</sup> the Commission would allow substituted compliance with the Transaction-Level Requirements applicable in the jurisdiction where the foreign branch is located *provided that*: (1) the aggregate notional value in US dollars and measured on a quarterly basis of the swaps of all the US SD/MSP's foreign branches, in foreign jurisdictions other than Australia, Canada, the European Union, Hong Kong, Japan or Switzerland, does not exceed five percent of the aggregate notional value of all of the swaps of the US SD/MSP; and (2) the US person maintains records with supporting information to verify that such five percent limit is not exceeded, as well as to identify, define, and address any significant risk from the failure to comply with the Transaction-Level Requirements.

**US Branch of a Non-US SD/MSP**

In a footnote the CFTC stated that it believes a US branch of a non-US SD/MSP would be subject to Transaction-Level Requirements, without substituted compliance.<sup>27</sup> The CFTC noted that although a branch does not have a separate legal identity apart from the parent bank, nonetheless, the CFTC has a strong interest in regulating the swap activities that occur in the United States.

**Non-US SDs/MSPs**

The Final Guidance provides that all non-US SDs/MSPs (including affiliates of a US person) should apply Category A Transaction-Level Requirements in relation to all swaps with (i) US persons (other than foreign branches of a US SD/MSP) and (ii) non-US persons that are Guaranteed or Conduit Affiliates. Category A Transaction-Level Requirements do not apply where a non-US SD/MSP (including an affiliate of a US person) enters into a swap with a non-US person that is not a Guaranteed or Conduit Affiliate.

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<sup>23</sup> However, a non-US SD/MSP must satisfy the daily trading record requirement in Commission Regulation 23.202(a)(1).

<sup>24</sup> US SD/MSPs are permitted to fulfill its regulatory obligations with respect to Category A Transaction-Level Requirements by tasking the foreign branch with compliance even though the US SD/MSP bears the ultimate responsibility for compliance.

<sup>25</sup> Note the Final Guidance seems to have an inconsistent application of the five percent exclusion. It is not clear if the exclusion applies to both SDs/MSPs or only SDs.

<sup>26</sup> Market participants or regulators in Australia, Canada, the European Union, Hong Kong, Japan and Switzerland have submitted requests for substituted compliance determinations.

<sup>27</sup> 78 FR at 45350 n.513.

**Capital Markets—Derivatives**

Substituted compliance would not be permitted when a swap is entered into by a non-US SD/MSP and a US person (other than a foreign branch of a US SD/MSP).<sup>28</sup> However, substituted compliance would be permitted when a swap is entered into by a non-US SD/MSP (including affiliates of a US person) and a non-US person that is a Guaranteed or Conduit Affiliate. In addition, substituted Compliance would be permitted when a swap is entered into by a non-US SD/MSP (including an affiliate of a US person) and a foreign branch of a US bank that is an SD/MSP.

**Application of Category B Transaction-Level Requirements**

Category B Transaction-Level Requirements either do or do not apply based on the counterparties to the swap. Where these requirements do apply, the Final Guidance provides that substituted compliance would not be permitted.

US SDs/MSPs (including affiliates of non-US persons) are required to comply with Category B Transaction-Level Requirements, (i.e., the external business conduct standards) regardless of whether the counterparty is a US or non-US person.

A foreign branch of a US SD/MSP is required to apply Category B Transaction-Level Requirements only if the counterparty is a US person (other than a foreign branch of a US SD/MSP). However, a foreign branch of a US SD/MSP transacting with a non-US person (whether or not a Guaranteed or Conduit Affiliate) generally would not apply Category B Transaction-Level Requirements because of the interest in the foreign jurisdiction applying its own Transaction-Level Requirements to a swap taking place outside the United States. Similarly, the same reasoning applies to a swap between two foreign branches of SD/MSPs—the Category B Transaction-Level Requirements would not apply.

A non-US SD/MSP (including an affiliate of a US person) transacting with a US person would apply Category B requirements and would not apply these requirements when transacting with a non-US person (whether or not a Guaranteed or Conduit Affiliate). Similarly, when transacting with a foreign branch of a US SD/MSP Category B requirements would not apply.

**Table D—Summary of Application of the Transaction-Level Requirements**

Table D summarizes application of the Transaction-Level Requirements to SDs/MSPs.

Entity	Counterparty			
	US person (other than foreign branch of US SD/MSP)	Foreign branch of US bank SD/MSP	Non-US person that is a Guaranteed or Conduit Affiliate	Non-US person that is <i>not</i> a Guaranteed or Conduit Affiliate
<b>US SD/MSP (including an affiliate of a non-US person)</b>	Category A: Apply	Category A: Apply	Category A: Apply	Category A: Apply
	Category B: Apply	Category B: Apply	Category B: Apply	Category B: Apply
<b>US SD/MSP (when it solicits and negotiates through a foreign subsidiary or affiliate)<sup>29</sup></b>	Category B: Apply	Category B: Do Not Apply	Category B: Do Not Apply	Category B: Do Not Apply
<b>Foreign branch of US bank SD/MSP</b>	Category A: Apply	Category A: Substituted Compliance	Category A: Substituted Compliance	Category A: Substituted Compliance <sup>30</sup>
	Category B: Apply	Category B: Do Not Apply	Category B: Do Not Apply	Category B: Do Not Apply

(Table D continued on next page)

28 Even though substituted compliance is not available between a non-US SD/MSP and a US person (other than a foreign branch of a US SD/MSP), a market participant can comply with home country requirements where the requirements are “essentially identical to the Dodd-Frank requirements.” The CFTC stated that the requirements would be evaluated on a provision-by-provision basis. Specifically, the CFTC staff has determined that the European Market Infrastructure Regulation (EMIR) regarding risk mitigation rules are essentially identical to Dodd-Frank requirements and would achieve compliance with the relevant Dodd-Frank requirements. See, No-Action Relief for Registered Swap Dealers and Major Swap Participants from Certain Requirements under Subpart I of Part 23 of Commission Regulations in Connection with Uncleared Swaps Subject to Risk Mitigation Techniques under EMIR, CFTC Letter No. 13-45 (July 11, 2013), <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/13-45.pdf>.

29 This category, which applies only to Category B (external business conduct rules), was added to the chart in Appendix E of the Final Guidance, but it is not discussed in the text of the Final Guidance.

30 Under limited exceptions, substituted compliance is available for swaps between foreign branches of US banks that are SDs/MSPs and a non-US person (other than a Guaranteed or Conduit Affiliate) where there is not a comparable foreign regulatory regime provided that the aggregate notional value of the swaps of all foreign branches in such country does not exceed five percent of the aggregate notional value of all swaps of the US SD/MSP and the US person maintains records with supporting information for the five percent limit as well as to identify, define and address any significant risk from non-application of the Transaction-Level Requirements.

**Capital Markets—Derivatives**

(Table D continued from prior page)

Entity	Counterparty			
<b>Non-US SD/MSP (including an affiliate of a US person)</b>	Category A: Apply	Category A: Substituted Compliance	Category A: Substituted Compliance	Category A: Do Not Apply
	Category B: Apply			Category B: Do Not Apply
	Do Not Apply under certain circumstances <sup>31</sup>	Category B: Do Not Apply	Category B: Do Not Apply	

**Non-Registrants**

Swap counterparties that are not registered as SDs/MSPs (“Non-Registrants”) are still required to comply with the regulations relating to required clearing, trade execution, real-time public reporting, Large Trader Reporting, SDR Reporting and swap data recordkeeping (collectively, the “Non-Registrant Requirements”).

Cross-border swaps between two Non-Registrants where one or both of the counterparties to the swap is a US person, the Non-Registrant Requirements will apply and substituted compliance is not available. Where a swap is between two non-US persons and neither counterparty is required to register as an SD/MSP, the Non-Registrant Requirements will not apply with the exception of Large Trader Reporting.

Swaps between two Non-Registrants that are not US persons, and each of the counterparties to the swap is a Guaranteed or Conduit Affiliate, the parties to the swap should comply with the Non-Registrant Requirements. However, substituted compliance is

allowed except with regard to Large Trader Reporting, and provided that SDR Reporting would be eligible for substituted compliance only if the Commission has direct access to all of the reported swap data elements that are stored at a foreign trade repository. Further, swaps between two Non-Registrants that are not US person where only one party is a Guaranteed or Conduit Affiliate, generally should not be expected to comply with Non-Registrant Requirements (except that the conditions of the inter-affiliate exemption should be satisfied (when the inter-affiliate exemption has been elected) and the real-time reporting requirements must be satisfied).<sup>32</sup>

Where a swap is executed anonymously by Non-Registrants (where one or both of the counterparties is a US person) on a registered DCM or SEF and cleared by a registered DCO, or a registered FBOT and cleared, neither party to the swap should be required to comply with the Non-Registrant Requirements that otherwise apply to the swap, with the exception of Large Trader Reporting, SDR Reporting, and swap data recordkeeping.

**Table E—Summary of Application of the Non-Registrant Requirements to Non-Registrants**

Table E summarizes application of the Entity-Level and Transaction-Level Requirements applicable to Non-Registrants.<sup>33</sup>

Entity	Counterparty		
	<b>US person (including an affiliate of non-US person)</b>	<b>Non-US person that is a Guaranteed or Conduit Affiliate</b>	<b>Non-US person that is not a Guaranteed or Conduit Affiliate</b>
<b>US person (including an affiliate of non-US person)</b>	Apply	Apply	Apply
<b>Non-US person that is a Guaranteed or Conduit Affiliate</b>	Apply	Substituted Compliance <sup>34</sup>	Do Not Apply, <i>except for</i> Large Trader Reporting
<b>Non-US person that is not a Guaranteed or Conduit Affiliate</b>	Apply	Do Not Apply, <i>except for</i> Large Trader Reporting	Do Not Apply, <i>except for</i> Large Trader Reporting

<sup>31</sup> Entity-Level and Transaction-Level Requirements do not apply where the swap is executed anonymously on a registered DCM or SEF and cleared by a registered DCO, or a registered FBOT and cleared.

<sup>32</sup> See Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21750 (April 11, 2013).

<sup>33</sup> Where a swap is executed anonymously by Non-Registrants (one or both of the counterparties is a US person) on a registered DCM or SEF and cleared by a registered DCO, or a registered FBOT and cleared, neither party to the swap should be required to comply with the Non-Registrant Requirements that otherwise apply to the swap, with the exception of Large Trader Reporting, SDR Reporting, and swap data recordkeeping.

<sup>34</sup> Substituted compliance does not apply to Large Trader Reporting, and provided that SDR Reporting would be eligible for substituted compliance only if the Commission has direct access to all of the reported swap data elements that are stored at a foreign trade repository.

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