
Alerts

Regulatory Developments: Treasury Publishes Final Determination Exempting Foreign Exchange Swaps and Forwards from Regulation as "Swaps" Under the CEA

November 20, 2012

Derivatives Insight

On November 16, 2012, the Department of the Treasury issued a final determination exempting both foreign exchange swaps ("FX swaps") and foreign exchange forwards ("FX forwards") from regulation as "swaps" under the Commodity Exchange Act ("CEA"), as amended by the Dodd-Frank Act. Under the CEA, a FX swap is narrowly defined as a transaction that solely involves—(A) an exchange of two different currencies on a specific date at a fixed rate that is agreed upon on the inception of the contract covering the exchange and (B) a reverse exchange of those two currencies at a later date and at a fixed rate that is agreed upon on the inception of the contract covering the exchange. A FX forward is likewise narrowly defined by the CEA as a transaction that solely involves the exchange of two different currencies on a specific future date at a fixed rate agreed upon on the inception of the contract covering the exchange.

The final determination of exemption follows a May 5, 2011, notice of proposed determination and covers substantially the same ground. Pursuant to the final determination, FX swaps and FX forwards will not be included in the definition of "swap" so long as such FX swaps and FX forwards are not structured to evade the Dodd-Frank Act. Specifically, FX swaps and FX forwards are exempted from central clearing and exchange trading requirements and will not count toward the required calculations in determining a person's swap dealer or major swap participant status. The exemption does not extend to other foreign exchange derivatives, such as options, currency swaps, and nondeliverable forwards which will still be subject to mandatory clearing and exchange-trading requirements.

The Treasury explained that the distinctive characteristics of FX swaps and FX forwards led to their determination. FX swaps and FX forwards have fixed payment obligations, are settled by an exchange of actual currency, and are predominantly short-term instruments. These characteristics, along with their trade in a highly-transparent, liquid and efficient market obviate the need for their regulation as "swaps" under the CEA. The Treasury also noted that requiring central clearing and trading under the CEA could introduce new unforeseen risks.

The exemption is narrowly tailored as FX swaps and FX forwards still remain subject to the CFTC's reporting requirements under Part 45 and 46 of the CFTC regulations, enhanced anti-evasion authority, and the business-conduct standards.

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