

An End-User's Guide to the CFTC's Final Cross-Border Guidance

August 8, 2013

Last month, the U.S. Commodity Futures Trading Commission (CFTC) issued final interpretive guidance with respect to the cross-border application of the Dodd-Frank Wall Street Reform and Consumer Protection Act's (Dodd-Frank Act) requirements for swaps ([Final Guidance](#)).¹ This Legal Alert examines the Final Guidance from an end-user's perspective.² It addresses the two key issues for end-users presented by the Final Guidance: (i) the "U.S. Person" definition, and (ii) the application of the Dodd-Frank Act's requirements for swaps to end-users (and certain issues related thereto).³

As demonstrated in Tables 1 and 2 below, U.S. Person end-users are generally subject, either directly or indirectly, to the Dodd-Frank Act's requirements, regardless of the status of their counterparties, whereas non-U.S. Person end-users (including those affiliated with U.S. Persons) may not be subject to many of the Dodd-Frank Act's requirements, depending on the status of their counterparties. Table 3 addresses a small subset of non-U.S. Persons whose ties to a U.S. Person(s) (including credit support from U.S. Persons(s) and whether swaps are transacted for U.S. Person affiliates) are such that they are accorded somewhat different treatment.⁴

1. "U.S. Person" Defined

The threshold question for determining whether the Dodd-Frank Act's requirements for swaps apply is whether a person is a "U.S. Person." Pursuant to the Final Guidance, the "U.S. Person" definition includes, but is not limited to, any of the following:

¹ The Final Guidance is intended to assist market participants in understanding how the substantive requirements of the Dodd-Frank Act for swaps would generally apply to their cross-border activities by, among other things, (i) defining the term "U.S. Person," (ii) addressing the aggregation of swaps activity for purposes of swap dealer and major swap participant registration and (iii) categorizing the Dodd-Frank Act's requirements for swaps into "Entity-Level Requirements," "Transaction-Level Requirements" and "Non-Registrant Requirements" and specifying how and when they would apply. However, it is important to note that the Final Guidance is not a binding rule adopted by the CFTC and, accordingly, the CFTC retains flexibility in the application of the Final Guidance to various situations, including consideration of all relevant facts and circumstances that are not expressly addressed in the Final Guidance. Furthermore, the Final Guidance only addresses the treatment of swaps for purposes of the Dodd-Frank Act, which are subject to the jurisdiction of the CFTC. Security-based swaps are subject to the jurisdiction of the Securities and Exchange Commission (SEC). The SEC has [proposed](#), but not finalized, rules concerning the cross-border application of the Dodd-Frank Act's requirements for security-based swaps. The Final Guidance was published in the Federal Register, and became effective, on July 26, 2013. The CFTC also issued an exemptive order that affords temporary relief with respect to the Final Guidance under certain conditions ([Exemptive Order](#)). The Exemptive Order is discussed in Section 4 below.

² As used in this Legal Alert, the term "end-user" refers to those persons (whether U.S. or non-U.S.) that are not (i) registered with the CFTC as a swap dealer or major swap participant and are not regulated as such or (ii) a foreign branch of a swap dealer or major swap participant.

³ Thus, issues relating to swap dealer and major swap participant registration, including the determination of whether a person must register as a swap dealer or major swap participant, and the application of the Dodd-Frank Act's requirements for swaps to swap dealers and major swap participants, are not addressed in this Legal Alert.

⁴ Aside from evaluating the implications of the Final Guidance in light of their cross-border swaps activities, end-users, whether they are U.S. Persons or non-U.S. Persons for purposes of the Final Guidance, should take care to analyze the tax implications of such activities.

- (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-U.S. persons and not offered to U.S. 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) bear 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).

All market participants are entitled to reasonably rely on representations from their counterparties as to their U.S. Person status, provided that reasonable due diligence is conducted. Whether the due diligence conducted is “reasonable” depends on the facts and circumstances. Accordingly, end-users should obtain, and expect to receive requests for, representations as to U.S. Person status from their counterparties.

It should be noted that the U.S. Person definition in the Final Guidance retains flexibility for the CFTC to deem a person not captured by one of the prongs listed above a U.S. Person. The rationale for this is that there may be circumstances that are not fully addressed in the U.S. Person definition that, based on the relevant facts and circumstances and a balancing of various regulatory interests that may apply, merit the treatment of a person as a U.S. Person. Such relevant facts and circumstances could include: (i) the strength of the connection between a person’s swap-related activities and U.S. commerce; (ii) the extent to which such activities are conducted in the U.S.; and (iii) the importance to the U.S. of regulating the person’s swap-related activities.

2. Dodd-Frank Act’s Requirements for Swaps

The Final Guidance categorizes the Dodd-Frank Act’s requirements for swaps as “Entity-Level Requirements,” “Transaction-Level Requirements” and “Non-Registrant Requirements.” The Entity-Level Requirements and Transaction-Level Requirements are only relevant where a swap dealer or major swap participant (whether or not a U.S. Person) is a counterparty to a trade, and the Non-Registrant

Requirements are relevant where both counterparties to a trade are end-users.⁵ The Entity-Level Requirements directly apply to the swap dealer or major swap participant counterparty, but may indirectly affect end-users. The Transaction-Level Requirements and Non-Registrant Requirements apply on a trade-by-trade basis.

DODD-FRANK ACT'S REQUIREMENTS FOR SWAPS

Entity-Level Requirements	Transaction-Level Requirements	Non-Registrant Requirements
<ul style="list-style-type: none"> ▪ <i>Category 1</i> <ul style="list-style-type: none"> ○ Capital ○ Chief Compliance Officer ○ Risk Management ○ Swap Data Recordkeeping (Except Certain Aspects of Swap Data Relating to Complaints and Marketing and Sales Materials) ▪ <i>Category 2</i> <ul style="list-style-type: none"> ○ General Reporting ○ Recordkeeping Relating to Complaints and Marketing and Sales Materials ○ Physical Commodity Large Trader Reporting 	<ul style="list-style-type: none"> ▪ <i>Category A</i> <ul style="list-style-type: none"> ○ Clearing ○ Margin and Segregation Requirements for Uncleared Swaps ○ Trade Execution ○ Swap Trading Relationship Documentation ○ Portfolio Reconciliation and Compression ○ Real-Time Reporting ○ Trade Confirmation ○ Daily Trading Records ▪ <i>Category B</i> <ul style="list-style-type: none"> ○ External Business Conduct Standards 	<ul style="list-style-type: none"> ▪ Clearing ▪ Trade Execution ▪ Real-Time Reporting ▪ Physical Commodity Large Trader Reporting ▪ General Reporting ▪ Recordkeeping

⁵ End-users should note that the Non-Registrant Requirements include requirements from both the Entity-Level Requirements and the Transaction-Level Requirements.

3. Application of the Dodd-Frank Act’s Requirements for Swaps to End-Users

The tables below indicate when end-users would be required to comply with the Dodd-Frank Act’s requirements for swaps.⁶ Transactions with foreign branches of U.S. Person swap dealers and major swap participants, guarantees, affiliate conduits and substituted compliance are each discussed in detail below, following the tables. Although a non-U.S. Person end-user may be exempt from having to comply with the Dodd-Frank Act’s requirements for swaps in certain circumstances, it will likely have to comply with the derivatives requirements of its home jurisdiction, if any.

TABLE 1. U.S. PERSON END-USER

			Entity-Level Requirements		Transaction-Level Requirements		Non-Registrant Requirements
			Category 1	Category 2	Category A	Category B	
Potential Counterparty	<i>U.S. Person</i>	SD or MSP	✓	✓	✓	✓	NA
		Foreign Branch	✓	✓	✓	✓	NA
		EU	NA	NA	NA	NA	✓
	<i>Non-U.S. Person</i>	SD or MSP	SC	✓	✓	✓	NA
		EU	NA	NA	NA	NA	✓
		EU that is Guaranteed by, or an Affiliate Conduit for, a U.S. Person(s)	NA	NA	NA	NA	✓

⁶ In each of the tables, “SD” stands for swap dealer, “MSP” stands for major swap participant and “EU” stands for end-user. In addition, a checkmark indicates that the relevant Dodd-Frank Act requirements for swaps apply, “SC” indicates that substituted compliance is possible and “NA” indicates that the relevant Dodd-Frank Act requirements for swaps do not apply.

TABLE 2. NON-U.S. PERSON END-USER

Potential Counterparty			Entity-Level Requirements		Transaction-Level Requirements		Non-Registrant Requirements
			Category 1	Category 2	Category A	Category B	
			U.S. Person	SD or MSP	✓	✓	
Foreign Branch	✓	✓		SC [*]	NA	NA	
EU	NA	NA		NA	NA	✓	
Non-U.S. Person	SD or MSP	SC	SC [*]	NA	NA	NA	
	EU	NA	NA	NA	NA	NA	
	EU that is Guaranteed by, or an Affiliate Conduit for, a U.S. Person(s)	NA	NA	NA	NA	NA	

^{*}A foreign branch may comply with a foreign jurisdiction's rules instead of the Dodd-Frank Act's requirements for swaps, even absent a substituted compliance determination from the CFTC, provided that the U.S. Person SD or MSP meets certain criteria. Please see the Final Guidance for more information.

^{*}Except for large trader reporting.

TABLE 3. NON-U.S. PERSON END-USER THAT IS GUARANTEED BY, OR AN AFFILIATE CONDUIT FOR, A U.S. PERSON(S)

Potential Counterparty			Entity-Level Requirements		Transaction-Level Requirements		Non-Registrant Requirements
			Category 1	Category 2	Category A	Category B	
			U.S. Person	SD or MSP	✓	✓	
Foreign Branch	✓	✓		SC [*]	NA	NA	
EU	NA	NA		NA	NA	✓	
Non-U.S. Person	SD or MSP	SC	SC ^{†*}	SC	NA	NA	
	EU	NA	NA	NA	NA	NA	
	EU that is Guaranteed by, or an Affiliate Conduit for, a U.S. Person(s)	NA	NA	NA	NA	SC [*]	

^{*}A foreign branch may comply with a foreign jurisdiction's rules instead of the Dodd-Frank Act's requirements for swaps, even absent a substituted compliance determination from the CFTC, provided that the U.S. Person SD or MSP meets certain criteria. Please see the Final Guidance for more information.

[†] Except for general reporting.

^{*}Except for large trader reporting.

a. Transactions with Foreign Branches of U.S. Swap Dealers or Major Swap Participants.

The Final Guidance takes the position that foreign branches of U.S. Person swap dealers and major swap participants are extensions of, and not legal entities that are separate from, the U.S. Persons. A foreign branch of a U.S. swap dealer or major swap participant qualifies as a “foreign branch” for purposes of the Final Guidance if it (i) (a) is subject to Regulation K, which is promulgated by the Board of Governors of the Federal Reserve under the authority of the Federal Reserve Act, 12 C.F.R. pt. 211 (2013), (b) is subject to Federal Deposit Insurance Corporation rules governing the operation of foreign branches, 12 C.F.R. pt. 347, or (c) is otherwise designated as a foreign branch by the U.S. 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) is subject to substantive regulation in banking or financing in the jurisdiction where it is located.

Moreover, the Final Guidance stipulates that a trade is considered to be with a foreign branch of a U.S. swap dealer or major swap participant only if all of the following factors are present:

- (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 U.S. swap dealer or major swap participant;
- (ii) The foreign branch or another foreign branch is the office through which the U.S. swap dealer or major swap participant 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 U.S. 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.

End-users that engage in swaps trading activity with foreign branches of U.S. Person swap dealers or major swap participants should consider requesting representations from such foreign branches indicating that (i) the foreign branches qualify as such pursuant to the Final Guidance and (ii) the relevant trading activity constitutes trading with a foreign branch, in accordance with the foregoing list of factors.

b. Guarantees.

The Final Guidance clarifies that the presence of a guarantee of a non-U.S. Person by a U.S. Person is insufficient to cause the non-U.S. Person to be a U.S. Person (pursuant to Prong (vii) of the U.S. Person definition). However, as indicated in the tables above, the presence of a guarantee from a U.S. Person could subject a non-U.S. Person to certain of the Dodd-Frank Act’s requirements for swaps.

In the Final Guidance, the term “guarantee” is interpreted broadly and includes not only traditional guarantees of payment or performance of swaps, but also other formal arrangements that, in view of all of the facts and circumstances, support a person’s ability to pay or perform its obligations with respect to swaps. Accordingly, keepwells, liquidity puts, certain types of indemnity agreements, master trust agreements, liability or loss transfer or sharing agreements, and any other explicit financial support arrangements could constitute “guarantees” for purposes of the Final Guidance.

c. Affiliate Conduits.

Similar to the presence of a guarantee, if a non-U.S. Person is an “affiliate conduit” for U.S. Persons, certain Dodd-Frank Act requirements for swaps would apply. According to the Final Guidance, factors that are relevant to considering whether a non-U.S. Person is an affiliate conduit for U.S. Persons include, but are not limited to, whether:

- (i) The non-U.S. Person is a majority-owned affiliate of a U.S. Person;
- (ii) The non-U.S. Person is controlling, controlled by, or under common control with a U.S. Person;
- (iii) The financial results of the non-U.S. Person are included in the consolidated financial statements of the U.S. Person; and
- (iv) The non-U.S. Person, in the regular course of business, engages in swaps with non-U.S. third-party(ies) for the purpose of hedging or mitigating risks faced by, or to take positions on behalf of, its U.S. affiliate(s), and enters into offsetting swaps or other arrangements with its U.S. affiliate(s) in order to transfer the risks and benefits of such swaps with third-party(ies) to its U.S. affiliates.

The CFTC’s rationale for subjecting affiliate conduits to certain Dodd-Frank Act requirements for swaps is that the economic reality of an affiliate conduit’s trading activity is such that the benefits and risks of such trading activity are ultimately attributed to the U.S. Persons. Since the aforementioned factors are not exclusive, non-U.S. Person end-users should carefully analyze their relationships with their U.S. Person affiliates with which, or on whose behalf, they engage in derivatives trading activity, to determine whether the economic reality of such trading could cause them to be affiliate conduits for their U.S. Person affiliates.

d. Substituted Compliance.

The Final Guidance provides that a non-U.S. Person may satisfy certain of the Dodd-Frank Act’s requirements for swaps by complying with the corresponding requirements of its home jurisdiction, but only so long as the CFTC has issued a determination finding that such corresponding requirements are comparable to the relevant Dodd-Frank Act requirements. To date, the CFTC has not issued any substituted compliance determinations, although requests for determinations have been submitted to the CFTC by regulators in Australia, Canada, the European Union, Hong Kong, Japan and Switzerland. It is anticipated that the CFTC will begin issuing substituted compliance determinations later this year.

3. The Exemptive Order

The Final Guidance became effective on July 26, 2013. However, certain market participants were afforded temporary relief by an Exemptive Order that the CFTC adopted on the same day as the Final Guidance.

The Exemptive Order retains the status-quo with respect to the U.S. Person definition because it permits market participants to continue to rely on an earlier version of the U.S. Person definition that was contained in a January exemptive order, in lieu of the U.S. Person definition in the Final Guidance, until October 9, 2013.⁷

⁷ The CFTC has restated the relevant U.S. Person definition in the Exemptive Order.

With respect to the Dodd-Frank Act's requirements for swaps, although the Exemptive Order affords relief to certain non-U.S. Person end-users meeting certain conditions, the Exemptive Order primarily focuses on (i) non-U.S. Person swap dealers and major swap participants and (ii) foreign branches of U.S. Person swap dealers and major swap participants. U.S. Persons are generally not afforded relief by the Exemptive Order.

End-users may wish to consider reviewing the Exemptive Order when trading with a non-U.S. Person to determine whether the Dodd-Frank Act's requirements for swaps would apply. Generally, with respect to the Dodd-Frank Act's requirements for swaps, the Exemptive Order affords relief until October 9, 2013 in many cases and, in some cases, until the earlier of December 21, 2013 and 30 days following the CFTC's issuance of a substituted compliance determination.

To the extent that the Exemptive Order does not expressly afford relief, end-users are required to comply with the relevant Dodd-Frank Act requirements for swaps that are currently effective, in accordance with the Final Guidance.



If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

James M. Cain	202.383.0180	james.cain@sutherland.com
Jacob Dweck	202.383.0775	jacob.dweck@sutherland.com
Daphne G. Frydman	202.383.0656	daphne.frydman@sutherland.com
Catherine M. Krupka	202.383.0248	catherine.krupka@sutherland.com
David T. McIndoe	202.383.0920	david.mcindoe@sutherland.com
R. Michael Sweeney, Jr.	202.383.0921	michael.sweeney@sutherland.com
Warren N. Davis	202.383.0133	warren.davis@sutherland.com
Meltem F. Kodaman	202.383.0674	meltem.kodaman@sutherland.com
Mark D. Sherrill	202.383.0360	mark.sherrill@sutherland.com
Cheryl I. Aaron	202.383.0917	cheryl.aaron@sutherland.com
Doyle Campbell	212.389.5073	doyle.campbell@sutherland.com
Kalaundra Y. Carreathers	202.383.0830	kally.carreathers@sutherland.com
Jeanette M. Curtis	202.383.0948	jeanette.curtis@sutherland.com
Meghan R. Gruebner	202.383.0933	meghan.gruebner@sutherland.com
Alexander S. Holtan	202.383.0926	alexander.holtan@sutherland.com
Raymond A. Ramirez	202.383.0868	ray.ramirez@sutherland.com