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Exemption of FX Forwards and Swaps from Swap Rules Under Dodd-Frank

On April 29, the U.S. Department of the Treasury published a formal notice of its intention to exclude Foreign Exchange Swaps and Foreign Exchange Forwards from the definition of swaps under provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The exclusion is being accomplished by exercise of the authority given to the Secretary of the Treasury in the Dodd-Frank Act to make a determination that those products "should not be regulated as swaps." As a result of the determination, FX Forwards and FX Swaps (1) cannot be subjected to mandatory clearing and exchange trading, and (2) will not count for purposes of determining a party's status as a Swap Dealer or Major Swap Participant. However, the exclusion is narrowly drawn so that those products will nevertheless be subject to certain other Dodd-Frank Act swap requirements, and other types of foreign exchange transactions that do not qualify as FX Swaps and FX Forwards will remain subject to the Dodd-Frank Act.

The primary limitation on the exclusion proposed by the Treasury is that it applies only to Foreign Exchange Forwards and Foreign Exchange Swaps as those terms are defined in the Dodd-Frank Act and not to foreign exchange transactions generally. A "Foreign Exchange Forward" is "a transaction that solely involves the exchange of 2 different currencies on a specific future date at a fixed rate agreed upon on the inception of the contract covering the exchange." A "Foreign Exchange Swap" is "a transaction that solely involves (A) and exchange of 2 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 the 2 currencies described in subparagraph (A) at a later date and at a fixed rate that is agreed upon on the inception of the contract covering the exchange." Nothing else is included in the determination, so foreign exchange options, currency swaps and non-deliverable forwards (because they are viewed as not involving an "exchange" of currencies) remain covered as "swaps" under the Dodd-Frank Act. (FX spot transactions, of course, are not covered by the Dodd-Frank Act at all because they are accepted as not having a forward element even if they settle as a matter of market practice one or two days after the relevant trade date.)

The other important limitation on the exclusion is that it does not free the two products from all Dodd-Frank Act swap rules. Specifically, (1) all Foreign Exchange Swaps and Forwards will have to be reported in the same manner as trades that fall within the swap definition, and (2) a Swap Dealer or Major Swap Participant engaging in those types of transactions will be held to the same business conduct standards that are generally applicable to swap transactions. It will also be illegal to use FX Swaps and Forwards to evade other derivatives reforms.

The Treasury is allowing a 30-day comment period on the proposed determination. Under the relevant provisions of the Dodd-Frank Act, the final determination by the Secretary of the Treasury will not be effective "until it is submitted to the appropriate committees of Congress." Although the Dodd-Frank Act does not identify the full list of such committees, it does say that the appropriate committees "include" the committees in both the House and Senate dealing with agricultural affairs.

The Treasury press release concerning the proposed determination can be found here.
The text of the Notice of Proposed Determination can be found here.

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