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Nearly at the Buzzer, CFTC Affords End-Users Relief from Dodd-Frank Reporting Requirements

April 19, 2013

On the brink of the compliance date for arguably one of the most burdensome requirements that end-users face under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the Commodity Futures Trading Commission's (CFTC) Divisions of Market Oversight (DMO) and Clearing and Risk (DCR) issued no-action letters affording end-users (1) temporary relief from the general, historical and real-time swap data reporting requirements under Dodd-Frank; and (2) conditional relief from the reporting requirements applicable to (a) interaffiliate swaps and (b) trade options. Please note, however, that the no-action letters discussed herein do not afford end-users any relief from the recordkeeping requirements under Part 45. This Legal Alert provides a high-level summary of the relief afforded by each of these letters and the conditions that end-users must meet to qualify for the relief.

1. Temporary Relief from the General, Historical and Real-time Swap Data Reporting Requirements

On the evening of April 9, 2013, with only a few hours left before the 12:01 a.m. scheduled reporting deadline for end-users, the DMO issued CFTC Letter No. 13-10 granting a temporary extension of the compliance date. However, as described below, CFTC Letter No. 13-10 distinguishes between, and affords distinct treatment to, financial entity end-users and non-financial entity end-users.[1]

a. Relief Afforded to Financial Entities

With regard to the general reporting (Part 45 of the CFTC's regulations) and real-time reporting (Part 43 of the CFTC's regulations) requirements, which would apply to trades executed on or after April 10, 2013 (*i.e.*, prospectively):

- No relief has been afforded with respect to *interest rate* and *credit swaps*. Therefore, the compliance date with respect to such swaps was 12:01 a.m. on **April 10, 2013**.[2]
- The reporting deadline for *equity*, *foreign exchange* and other *commodity swaps* has been extended to 12:01 a.m. on **May 29, 2013**.
  - As a condition of the relief, data for swaps entered into between April 10, 2013 and May 29, 2013 must be backloaded and reported to a swap data repository (SDR), in accordance with Part 45, by 12:01 a.m. on **June 29, 2013**.

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[1] The term "financial entity" is defined in Section 2(h)(7)(C)(i) of the Commodity Exchange Act, 7 U.S.C. § 2(h)(7)(C)(i), and means: (1) a swap dealer; (2) a security-based swap dealer; (3) a major swap participant; (4) a major security-based swap participant; (5) a commodity pool; (6) a private fund, as defined in Section 202(a) of the Investment Advisers Act of 1940; (7) an employee benefit plan as defined in paragraphs (3) and (32) of Section 3 of the Employee Retirement Income Security Act of 1974; or (8) a person predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature, as defined in Section 4(k) of the Bank Holding Company Act of 1956. The term does not include an entity whose primary business is providing financing that uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90% or more of which arise from financing that facilitates the purchase or lease of products, 90% or more of which are manufactured by the parent company or another subsidiary of the parent company. Moreover, for purposes of CFTC Letter No 13-10, "small financial institutions" that are eligible for the end-user exception are also carved out of the financial entity definition. *See* CEA § 2(h)(7)(C)(ii), 7 U.S.C. § 2(h)(7)(C)(ii), and CFTC Regulation 50.50(d), 17 C.F.R. § 50.50(d) (2013).

[2] All references in this Legal Alert are to Eastern time.

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With regard to the historical reporting (Part 46 of the CFTC's regulations) requirement:

- The reporting deadline for *all asset classes* has been extended to 12:01 a.m. on **September 30, 2013**.
  - Any swap entered into prior to 12:01 a.m. on April 10, 2013 will be reported as a historical swap (*i.e.*, the extension of the compliance deadlines for reporting under Parts 43 and 45 does not cause swaps executed between the original deadline and the revised deadline to be classified as historical swaps).[3]

b. Relief Afforded to Non-Financial Entities

With regard to the general reporting (Part 45 of the CFTC's regulations) and real-time reporting (Part 43 of the CFTC's regulations) requirements, which would apply to trades executed on or after April 10, 2013 (*i.e.*, prospectively).

- The reporting deadline for *interest rate* and *credit swaps* has been extended to 12:01 a.m. on **July 1, 2013**.
  - As a condition of the relief, data for swaps entered into between April 10, 2013 and July 1, 2013 must be backloaded and reported to an SDR, in accordance with Part 45, by 12:01 a.m. on **August 1, 2013**.
- The reporting deadline for *equity*, *foreign exchange* and *other commodity swaps* has been extended to 12:01 a.m. on **August 19, 2013**.
  - As a condition of the relief, data for swaps entered into between April 10, 2013 and August 19, 2013 must be backloaded and reported to an SDR, in accordance with Part 45, by 12:01 a.m. on **September 19, 2013**.

- With regard to the historical reporting (Part 46 of the CFTC's regulations) requirement:
  - The reporting deadline for *all asset classes* has been extended to 12:01 a.m. on **October 31, 2013**.
    - Any swap entered into prior to 12:01 a.m. on April 10, 2013 will be reported as a historical swap (*i.e.*, the extension of the compliance deadlines for reporting under Parts 43 and 45 does not cause swaps executed between the original deadline and the revised deadline to be classified as "historical").

[3] "Historical" swaps are (1) "pre-enactment swaps," which are swaps entered into prior to the enactment of the Dodd-Frank Act (July 21, 2010), the terms of which had not expired as of that date and (2) "transition swaps" are swaps that were entered into on or after the enactment of the Dodd-Frank Act (July 21, 2010) and prior to the applicable compliance date for reporting historical swaps data pursuant to Part 46 (*i.e.*, April 10, 2013).

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The following chart summarizes the relief afforded by CFTC Letter No. 13-10.

<table>
<tr><th>Entity types</th><th>Swap Asset Classes</th><th>Swap Data Reporting Obligation</th><th>Original Compliance Date</th><th>Extended Compliance Date</th></tr>
<tr><td rowspan="6">Financial Counterparty</td><td>Interest Rate / Credit Default</td><td>Part 43 (Real Time)</td><td>April 10, 2013</td><td>No extension</td></tr>
<tr><td>Interest Rate / Credit Default</td><td>Part 45 (General Reporting)</td><td>April 10, 2013</td><td>No extension</td></tr>
<tr><td>Equity / FX / Commodity</td><td>Part 43 (Real Time)</td><td>April 10, 2013</td><td>May 29, 2013</td></tr>
<tr><td>Equity / FX / Commodity</td><td>Part 45 (General Reporting)</td><td>April 10, 2013</td><td>May 29, 2013</td></tr>
<tr><td colspan="3">As a condition of relying on the relief for equity/FX/commodity swaps reporting, financial entities must backload and report to an SDR all swap transaction data for the period from April 10, 2013 to May 29, 2013 that they would have been required to report pursuant to Part 45 (General Reporting) in the absence of relief.</td><td>June 29, 2013</td></tr>
<tr><td>All</td><td>Part 46 (Historical Swaps Data)</td><td>April 10, 2013</td><td>September 30, 2013</td></tr>
<tr><td colspan="5"></td></tr>
<tr><td rowspan="7">Non-Financial Counterparty</td><td>Interest Rate / Credit Default</td><td>Part 43 (Real Time)</td><td>April 10, 2013</td><td>July 1, 2013</td></tr>
<tr><td>Interest Rate / Credit Default</td><td>Part 45 (General Reporting)</td><td>April 10, 2013</td><td>July 1, 2013</td></tr>
<tr><td colspan="3">As a condition of relying on the relief for equity/FX/commodity swaps reporting, non-financial entities must backload and report to an SDR all swap transaction data for the period from April 10, 2013 to July 1, 2013 that they would have been required to report pursuant to Part 45 (General Reporting) in the absence of this no-action relief.</td><td>August 1, 2013</td></tr>
<tr><td>Equity / FX / Commodity</td><td>Part 43 (Real Time)</td><td>April 10, 2013</td><td>August 19, 2013</td></tr>
<tr><td>Equity / FX / Commodity</td><td>Part 45 (General Reporting)</td><td>April 10, 2013</td><td>August 19, 2013</td></tr>
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<tr><td>All</td><td>Part 46 (Historical Swaps Data)</td><td>April 10, 2013</td><td>October 31, 2013</td></tr>
</table>

End-users should note that CFTC Letter No. 13-10 in no way affects the swap data recordkeeping obligations that apply to them. Accordingly, records regarding any swap entered into by an end-user prior to April 10, 2013 must be maintained in accordance with Parts 43, 45 and 46 of the CFTC's regulations. As part of the recordkeeping obligations under Part 45, end-users should have obtained CFTC Interim Compliant Identifiers (CICIs) by April 10, 2013.

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2. Conditional Relief with Respect to the Reporting of Interaffiliate Swaps

On April 5, 2013, the DCR issued CFTC Letter No. 13-09, which provides varying degrees of relief from the CFTC's general reporting (Part 45), historical reporting (Part 46) and end-user exception reporting (Regulation 50.50(b)) requirements for certain inter-affiliate swaps. The relief provided in CFTC Letter No. 13-09 is not time limited; however, conditions attached to the relief may be problematic for many end-user market participants entering into swaps with non-U.S. affiliates.

The scope of the relief from Part 45 and CFTC Regulation 50.50(b) varies depending on whether the entities entering into a swap are *wholly-owned* affiliates or *majority-owned* affiliates, while the scope of the relief from Part 46 applies to both wholly-owned and majority-owned affiliates. We discuss each of these categories below:

a. Reporting Relief for Swaps Between Wholly-Owned Affiliates

CFTC Letter No. 13-09 entirely exempts swaps between wholly-owned affiliates from Part 45 and Regulation 50.50(b) reporting requirements if the following seven conditions are satisfied:

i. The affiliates entering into the swap are wholly-owned affiliates (*e.g.,* 100% common ownership) and are consolidated for financial reporting purposes under Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS);

ii. The affiliates are not directly or indirectly affiliated with a swap dealer, major swap participant, or an entity designated as systemically important by the Financial Stability Oversight Council;

iii. The swap is not executed on a swap execution facility (SEF), designated contract market (DCM), or a foreign board of trade (FBOT);

iv. The swap is not cleared by a derivatives clearing organization (DCO);

v. The entities are not exercising the inter-affiliate clearing exemption set forth in CFTC regulation 50.52(c);[4]

vi. All swaps entered into between either one of the affiliated counterparties and an unaffiliated counterparty (regardless of the location of the affiliated counterparty) are reported to an SDR registered with the CFTC, pursuant to, or as if pursuant to, parts 43 (real-time reporting), 45, and 46 of the CFTC's regulations; and

vii. The reporting counterparty relying on CFTC Letter No. 13-09 maintains all records required under Part 45 in a reportable format and generates a unique alphanumeric swap identifier for each inter-affiliate swap not reported to an SDR.

[4] Note that this exception is different than the end–user clearing exemption set forth in CFTC regulation 50.50, which is available for inter-affiliate swaps that satisfy the criteria necessary to elect that exemption. As such, the exception in CFTC regulation 50.52(c) would likely be exercised only if a swap is between two affiliated financial entities or if the swap was speculative for both counterparties

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Two of the conditions above could limit the value of the relief granted by CFTC Letter No. 13-09. *First*, the second condition prohibits affiliates of swap dealers and major swap participants from availing themselves of the relief afforded by the letter. The CFTC does not separately define "affiliate" in CFTC Letter No. 13-09 for purposes of this condition and, without further guidance, the relief afforded will not be available to entities with swap dealers or major swap participants that are either direct or indirect majority-owned affiliates. The relief may also not be available to entities that have swap dealers and/or major swap participants that are affiliates at less than the majority-owned level.[5]

Second, the sixth condition above requires that all market-facing swaps (*i.e.*, swaps with unaffiliated counterparties) entered into by an affiliate that also enters into inter-affiliate swaps be reported to an SDR registered with the CFTC. This applies even if the market-facing swap is with a non-U.S. affiliate, notwithstanding the CFTC's exemptive order regarding the application of Dodd Frank Act requirements outside of the U.S.[6] For example, if a U.K. entity engages in swaps with a U.S. affiliate but also enters into swaps with unaffiliated U.K. counterparties, and such offshore swaps are not reported to a registered SDR, then all inter-affiliate swaps entered into between the U.K. and U.S. affiliates would be reportable under Part 45 (assuming no other relief applies).

The sixth condition referenced above does not present an issue for: (1) affiliates that only enter into swaps with other affiliates; (2) U.S. affiliates that only enter into swaps with other U.S. affiliates in addition to U.S. market-facing swaps that are reported to an SDR registered with the CFTC; and (3) affiliates that only enter market-facing swaps with entities that report to a U.S. SDR (whether or not required to do so, *e.g.*, as a swap dealer, major swap participant or otherwise), in addition to their inter-affiliate swaps. In the case of an affiliate transacting in a swap with an unaffiliated U.S. entity, the CFTC's regulations already require that those swaps be reported to an SDR registered with the CFTC by the U.S. party, unless reported by the other party (*e.g.*, because it is a registered swap dealer). In the case of a non-U.S. affiliate transacting in a swap with an unaffiliated non-U.S. swap dealer or non-U.S. major swap participant, CFTC regulations dictate that many of those swaps be reported to an SDR *or*, when available, to a data repository in a jurisdiction in which substitute compliance is available. However, the reporting relief for affiliates would only be available to an affiliate for its inter-affiliate swaps to the extent that the non-US swap dealer or non-US major swap participant unaffiliated counterparty reports these swaps to a U.S. SDR.

For companies with non-U.S. affiliates that do enter into market-facing swaps that would fail the sixth condition in CFTC Letter No. 13-09 (*e.g.*, swap transactions between a non-U.S. affiliate and a non-U.S. unaffiliated counterparty), the number of those market-facing swaps might be less than the number of inter-affiliate swaps that would otherwise need to be reported if the relief were not available. In that case, to rely on the relief afforded in CFTC Letter No. 13-09, those companies would need to decide whether to report all of their inter-affiliate swaps (but not their non-US market-facing swaps), or only their non-US market-facing swaps to a U.S. SDR (but not their inter-affiliate swaps) that have not otherwise been reported..

b. Reporting Relief for Swaps Between Majority-Owned Affiliates

[5] It is unclear whether the CFTC intended this to be the case, as footnote 14 to the CFTC Letter No. 13-09 states: "In effect, this condition requires that the affiliated counterparties are not part of a corporate group that includes an affiliate that is a swap dealer or a major swap participant."

[6] *See* Final Exemptive Order Regarding Compliance With Certain Swap Regulations at http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-31736a.pdf

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CFTC Letter No. 13-09 allows quarterly reporting at the transaction level of swaps between majority-owned affiliates under Part 45 and Regulation 50.50(b) if the following nine criteria are satisfied:

i. The affiliates entering into the swap are majority-owned affiliates (*e.g.,* over 50% common ownership) and are consolidated for financial reporting purposes under GAAP or IFRS;

ii. The affiliates are not directly or indirectly affiliated with a swap dealer, major swap participant, or an entity designated as systemically important by the Financial Stability Oversight Council;

iii. The swap is not executed on a SEF, DCM, or FBOT;

iv. The swap is not cleared by a DCO;

v. The entities are not exercising the inter-affiliate clearing exemption set forth in CFTC regulation 50.52(c);

vi. All swaps entered into between either one of the affiliated counterparties and an unaffiliated counterparty (regardless of the location of the affiliated counterparty) are reported to an SDR registered with the CFTC, pursuant to, or as if pursuant to, parts 43, 45, and 46 of the CFTC's regulations;

vii. The reporting counterparty relying on the relief afforded in CFTC Letter No. 13-09 maintains all records required under Part 45 for relevant inter-affiliate swaps in a reportable format;

viii. The swap is not reportable under Part 43 (real-time reporting);[7] and

ix. Swaps for which the relief in CFTC Letter No. 13-09 is relied upon must be reported to an SDR within 30 days of the end of each fiscal quarter, with the first reporting obligation occurring within 30 days of June 30, 2013.

The relief for inter-affiliate swaps between majority-owned affiliates is subject to the two issues noted above (relating to the second and sixth conditions). In addition, as inter-affiliate swaps between majority-owned affiliates still must be reported at the transaction level, the only relief for majority-owned affiliates provided in CFTC Letter No. 13-09 is with respect to the reporting timeframes.

c. Historical Reporting Requirements

CFTC Letter 13-09 provides blanket relief from the Part 46 reporting obligations for inter-affiliate swaps that meet the following five criteria:

[7] Part 43 applies only to "publicly reportable swap transactions," which is generally defined as any "swap that is an arm's-length transaction between two parties that results in a corresponding change in the market risk position between the two parties." This term has generally been viewed as not applying to bilateral swaps entered into between majority-owned affiliates.

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i. The affiliates entering into the swap are wholly-owned (*e.g.,* 100% common ownership) or majority-owned affiliates (*e.g.,* over 50% common ownership) and are consolidated for financial reporting purposes under GAAP or IFRS;

ii. The affiliates are not directly or indirectly affiliated with a swap dealer, major swap participant, or an entity designated as systemically important by the Financial Stability Oversight Council;

iii. The swap is not executed on a SEF, DCM, or FBOT;

iv. The swap is not cleared by a DCO; and

v. All records of the relevant swaps are kept in compliance with Part 46.

Many entities entering into inter-affiliate swap transactions may be able to satisfy these five criteria and avail themselves of the relief from reporting historical swaps under Part 46 of the CFTC's regulations. Note that Part 46 recordkeeping requirements (as per the fifth condition) would still apply to these transactions.

3. Conditional Relief with Respect to the Reporting of Trade Options

Also on April 5, 2013, the DMO issued CFTC Letter No. 13-08 which, as described below, provides relief from the reporting of trade options pursuant to Part 45 of the CFTC's regulations. The relief afforded in CFTC Letter No. 13-08 is not time-limited and, therefore, will remain in effect until the CFTC provides additional guidance.

As market participants may know, non-financial commodity options are swaps and, thus, are subject to the same rules that apply to swaps generally. However, the CFTC adopted interim final regulations last year that exempt a commodity option from certain Dodd-Frank Act requirements if:

- The offeror of the option is an eligible contract participant or a producer, processor or commercial user of, or a merchant handling, the commodity which is the subject of the commodity option, or the byproducts thereof, and is offering or entering into the transaction solely for purposes related to its business as such;

- The offeree of the option is a producer, processor or commercial user of, or a merchant handling the commodity which is the subject of the commodity option, or the products or by-products thereof, and is entering into the transaction solely for purposes related to its business as such; and

- Both parties intend that the commodity option be physically settled so that, if exercised, the option would result in the sale of an exempt or agricultural (*i.e.*, non-financial) commodity for immediate (spot) or deferred (forward) shipment or delivery.[8]

The counterparties to commodity options that meet all three of the aforementioned requirements, called "trade options," are exempt from, among other things, having to comply with the general, historical and

[8] CFTC regulation 32.3, 17 C.F.R. § 32.3 (2013). For more information, please see Sutherland's May 3, 2012 Legal Alert, CFTC Adopts Final Rule to Treat Commodity Options as Swaps; Provides Exemption for Physical Options.

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real-time swap data reporting requirements with respect to the trade option. Instead, trade option counterparties may complete a “Form TO” to report information about the trade options they enter into; Form TO must be completed and filed with the CFTC on an annual basis.

However, pursuant to the interim final rules, the counterparties to a trade option would only be able to use Form TO in lieu of complying with the general reporting requirements under Part 45 of the CFTC’s rules if neither counterparty to the trade option has acted as the reporting counterparty, pursuant to Part 45 of the CFTC’s regulations, with respect to other swaps, during the twelve months preceding the trade option. If one of the parties has previously served as a reporting counterparty, Form TO cannot be used and the trade option must be reported in accordance with Part 45.

CFTC Letter No. 13-08 reverses this carve out and provides that end-users may use Form TO to report their trade options, irrespective of whether they have served as the reporting counterparty under Part 45 for other types of swaps. Accordingly, as a result of CFTC Letter No. 13-08, all end-user trade options will be reportable on Form TO. The only requirement for qualifying for the CFTC Letter No. 13-08 relief, other than satisfying the criteria to qualify for the trade option described above, is that end-users must notify the CFTC via e-mail, if and when they have entered into trade options with an aggregate notional value of over $1 billion within a given calendar year. The notification must occur within 30 days of crossing the $1 billion threshold.[9]

CFTC Letter No. 13-08 also provides certain recordkeeping relief. However, the end-user recordkeeping requirement (CFTC regulation 45.2) remains in effect, so the practical implications of this portion of the relief are minimal.

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.

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[9] Per CFTC Letter No. 13-08, the notional value of a trade option is to be calculated by multiplying (1) the maximum volume of commodity that can be purchased or sold under a trade option by (2) the fair market value of the maximum value of such commodity. To the extent that the price reference for the trade option is a variable index, the value of the index at execution should be the price used to calculate notional value.

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