

## Navigating Key Dodd-Frank Rules Related to the Use of Swaps by End Users

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“**Title VII**”) enacted a new regime for the substantive regulation of over-the-counter (“**OTC**”) derivatives under the U.S. securities and commodities laws. Although the Securities and Exchange Commission (“**SEC**”) has not yet completed several of the key Title VII rulemakings for “security-based swaps,” the Commodity Futures Trading Commission (the “**CFTC**”) has largely completed its Title VII rulemakings for “swaps.” Many of the regime’s requirements focus on “swap dealers” (“**SDs**”) and “major swap participants” (“**MSPs**”). Even so, commercial and financial entities that enter into OTC derivatives transactions for investment or hedging purposes, referred to as “**end users**,” will also become subject to a wide range of substantive requirements.

In particular, end users need to:

- determine whether the derivatives they use are required to be cleared or to be traded on a regulated execution facility and, if so, whether they are eligible for, and have completed the steps necessary for, reliance on the exception available for commercial end users;
- determine whether they must exchange collateral with their derivatives counterparties;
- obtain legal entity identifiers for the purpose of public and regulatory reporting requirements;
- maintain full, complete and systematic records with respect to their swap transactions;
- enter into the latest International Swaps and Derivatives Association (“**ISDA**”) Dodd-Frank Protocols or otherwise amend existing swap agreements;
- comply with CFTC position limit requirements; and
- comply with CFTC anti-fraud and anti-manipulation regulations.

Under guidance issued by the CFTC, non-U.S. end users are generally not subject to such requirements with respect to swaps entered into with other non-U.S. counterparties. Appendix A to this memorandum is a table summarizing the requirements applicable to end users. Appendix B summarizes the cross-border application of the CFTC’s Title VII rules. Appendix C is a list of key CFTC Title VII rulemakings.

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### Which Derivatives Are Subject to Title VII?

- **In General.** Title VII regulates a variety of previously unregulated derivatives, including interest rate swaps (“**IRS**”); non-spot foreign exchange transactions (unless exempted as described below); currency swaps; physical commodity swaps; total return swaps; and credit default swaps (“**CDS**”). Title VII divides this group of previously unregulated derivatives into two categories: “**swaps**” (which come under the jurisdiction of the CFTC) and “**security-based swaps**” (which come under the jurisdiction of the SEC.) As noted above, the SEC has not yet finalized most of its substantive rules. Accordingly, this memorandum does not address the regulation of security-based swaps.
- **What Is a “Swap”?** The term “swap” is broadly defined and, unless an exclusion applies, includes a wide range of agreements, contracts or transactions linked to an array of underliers such as physical commodities, rates, foreign currencies, broad-based security indices or U.S. government or other exempt securities (other than municipal securities).<sup>1</sup> OTC derivatives based on a single non-exempt security or narrow-based security index are generally security-based swaps. An index of securities is generally considered narrow-based unless it includes more than nine securities that satisfy certain trading volume, market capitalization and/or public information availability criteria and is not too heavily weighted toward a small number of securities.
- **Exemption for Physically-Settled Foreign Exchange Swaps and Forwards.** The U.S. Secretary of the Treasury has exempted certain physically-settled foreign exchange swaps and foreign exchange forwards from some Title VII requirements. The exemption does not apply to several commonly traded foreign exchange products, such as non-deliverable foreign exchange forwards, foreign exchange options or currency swaps. In addition, exempt foreign exchange swaps and foreign exchange forwards remain subject to the regulatory reporting requirements and external business conduct standards discussed later in this memorandum.
- **Excluded Instruments.** Some common financial products are excluded from the Title VII framework. These include listed futures and options on listed futures,<sup>2</sup> listed and unlisted options on securities and on broad- and narrow-based security indices, commodity trade options,<sup>3</sup> securities repurchase agreements, securities lending agreements, depository instruments, security forwards and non-financial commodity forwards intended to be physically settled. The CFTC retains anti-evasion authority with respect to the structuring of certain transactions to evade regulation.

### Who Is an End User?

- **In General.** Title VII created two new categories of registration for SDs and MSPs. SDs and MSPs are subject to comprehensive regulation, including capital, margin, documentation, reporting, recordkeeping and internal and external business conduct requirements.

<sup>1</sup> For these purposes the term “exempt securities” means certain securities exempted under Section 3(a)(12) of the Securities Exchange Act of 1934 (the “**Exchange Act**”), but does not include, among other securities, municipal securities. Examples of exempted securities include U.S. Treasuries and securities issued by the Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac).

<sup>2</sup> Listed futures and options on listed futures remain subject to a pre-existing comprehensive regulatory framework under the Commodity Exchange Act (“**CEA**”) and CFTC regulations thereunder.

<sup>3</sup> The CFTC has exempted from many Title VII rules trade option transactions that are between either two users of the commodity or between a user of the commodity and an eligible contract participant (“**ECP**”). In this context, a user of the commodity is a person that is a producer, processor or commercial user of, or a merchant handling the commodity that is the subject of, the trade option transaction, or the products or byproducts thereof, and that is offered or entering into the trade option transaction solely for purposes related to its business. The trade option must also be intended to be physically settled. Such transactions are exempt from many Title VII requirements, including public reporting and clearing (both discussed below), but remain subject to certain limited regulatory reporting requirements designed for trade options.

- **SDs.** An entity is regarded as a swap dealer if it: (i) holds itself out as a dealer in swaps; (ii) makes a market in swaps; (iii) regularly enters into swaps as an ordinary course of business for its own account; or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps.<sup>4</sup> Title VII provides a de minimis exception from designation as a swap dealer for a person that enters into less than \$8 billion of gross notional value in swaps connected to dealing activities over the preceding twelve months.<sup>5</sup> An entity must aggregate the swap activity of all of its affiliates under common control (other than affiliates that are themselves registered as SDs) for purposes of the de minimis calculation.
- **MSPs.** Even if an entity is not an SD, it may still become subject to registration with the CFTC if: (i) it maintains a “substantial position” in any major category of swaps, excluding (I) positions held for hedging or mitigating commercial risk and (II) positions maintained by an employee benefit or governmental plan, as defined under the Employee Retirement Income Security Act of 1974 (“ERISA”), for the primary purpose of hedging or mitigating risks directly associated with the operation of the plan; (ii) its swaps create “substantial counterparty exposure”; or (iii) it is a private fund or other “financial entity” that is highly leveraged, is not subject to capital requirements established by an appropriate Federal banking agency and maintains a “substantial position” in a major category of swaps.
  - A “substantial position” is defined (i) in the case of rate or currency swaps, as (A) \$3 billion in negative mark-to-market exposure or (B) \$6 billion in negative mark-to-market plus potential future exposure or (ii) in the case of credit, equity or commodity swaps, as (A) \$1 billion in negative mark-to-market exposure or (B) \$2 billion in negative mark-to-market plus potential future exposure.
  - “Substantial counterparty exposure” is defined as (i) \$5 billion in negative mark-to-market exposure across all swaps or (ii) \$8 billion in negative mark-to-market plus potential future exposure across all swaps.
- **Cross-Border Application.** Under CFTC cross-border guidance, under certain conditions, the calculation of these thresholds by a non-U.S. person that is not guaranteed by, or a “conduit affiliate” of, a U.S. person excludes swaps with (i) foreign branches of U.S. persons that are registered as SDs and (ii) non-U.S. persons other than guaranteed affiliates of U.S. persons where such affiliates are not registered as SDs.<sup>6</sup>
- **End Users.** Title VII also applies to end users that do not qualify as SDs or MSPs. Title VII divides end users into two broad categories—financial and non-financial end users.

<sup>4</sup> The CFTC has indicated that it interprets this definition in a manner similar to (although not bounded by) the SEC’s dealer/broker distinction. See 77 Fed. Reg. 30,596 at 30,607 (May 23, 2012) (the “**Registered Swap Entity Final Rule**”).

<sup>5</sup> See Registered Swap Entity Final Rule. A smaller, \$25 million notional cap applies in the case of swap dealing with certain “**Special Entities**.” Special Entities include any (i) Federal agency; (ii) State, State agency, city, county, municipality or other political subdivision of a State; (iii) employee benefit plan subject to Title I of ERISA; (iv) governmental plan, as defined in Section 3 of ERISA; (v) endowment, including an endowment that is an organization described in Section 501(c)(3) of the Internal Revenue Code of 1986; or (vi) employee benefit plan defined in Section 3 of ERISA, not otherwise defined as a Special Entity, that elects to be a Special Entity by notifying an SD or MSP of its election prior to entering into a swap with such SD or MSP. After the expiration of the phase-in period in December 2017, the \$8 billion cap will decrease to \$3 billion, unless the CFTC decides to set it at a different level.

<sup>6</sup> For more detail on these cross-border issues, see “Will Title VII Impose Requirements on Swaps Between Non-U.S. Persons” below.

- **Financial End Users.** An end user is a financial end user if it is a commodity pool,<sup>7</sup> private fund,<sup>8</sup> employee benefit plan<sup>9</sup> or person that is 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.
  - **“Predominantly Engaged in Activities that Are Financial In Nature.”** According to final rules under Title I of the Dodd-Frank Act, an entity is “predominantly engaged in activities that are financial in nature”<sup>10</sup> if in either of its last two fiscal years:
    - the annual gross revenues derived by the company and all of its subsidiaries from activities that are financial in nature represents 85 percent or more of the consolidated annual gross revenues of the company; or
    - the consolidated assets of the company and all of its subsidiaries related to activities that are financial in nature represents 85 percent or more of the consolidated assets of the company.<sup>11</sup>
  - **Accounting for Subsidiaries.** Under this standard, an end user may take into account its own gross revenues and/or assets as well as the gross revenues and/or assets of all of its consolidated subsidiaries in determining whether it qualifies as a financial end user. This is true even if the end user is an intermediate holding company.

<sup>7</sup> In general, a “commodity pool” is any investment trust, syndicate or similar form of enterprise operated for the purpose of trading in derivatives regulated by the CFTC, including swaps or futures. See CEA § 1a(10).

<sup>8</sup> A “private fund” is an issuer that would be an investment company, as defined in the Investment Company Act of 1940, but for sections 3(c)(1) and 3(c)(7) of that Act. See Investment Advisers Act of 1940 § 202(a)(29).

<sup>9</sup> For purposes of this memorandum, an “employee benefit plan” means an employee benefit plan or governmental plan as defined in paragraphs (3) and (32) of section 3 of ERISA, respectively. See CEA § 2(h)(7)(C)(i)(VII).

<sup>10</sup> Activities that are financial in nature include (1) lending, exchanging, transferring, investing for others or safeguarding money and securities; (2) certain insurance activities; (3) providing financial, investment or economic advisory services, including advising an investment company; (4) securitizing; (5) underwriting, dealing in or making a market in securities; (6) extending credit and servicing loans; (7) activities related to extending credit (e.g., real estate and personal property appraising, arranging commercial real estate financing, collection agency services, credit bureau services); (8) certain leasing of personal or real property; (9) operating nonbank depository institutions; (10) trust company functions; (11) financial and investment advisory activities (including providing information, statistical forecasting and advice with respect to any transaction in swaps); (12) securities and derivatives brokerage, riskless principal and private placement services; (13) investment transactions as principal; (14) management consulting and counseling activities; (15) support services in connection with financial activities; (16) community development activities; (17) issuance and sale of money orders, savings bonds and traveler’s checks; (18) processing of financial, banking or economic data; (19) providing administrative and other services to mutual funds; (20) owning shares of a securities exchange; (21) acting as a certification authority for digital signatures and authenticating the identity of a person; (22) providing employment histories to third parties for use in making credit decisions; (23) check cashing and wire transmission services; (24) postage, vehicle registration or public transportation services; (25) real estate title abstracting; (26) operating a travel agency in connection with financial services; (27) organizing, sponsoring and managing a mutual fund; (28) merchant banking; (29) lending, exchanging, transferring, investing for others or safeguarding financial assets other than money or securities; (30) providing any device or other instrumentality for transferring money or other financial assets; and (31) arranging, effecting or facilitating financial transactions for the account of third parties. See 12 C.F.R. Part 242 (Apr. 5, 2013) (Board of Governors of the Federal Reserve System (“**Federal Reserve**”) rule defining “Predominantly Engaged in Financial Activities”).

<sup>11</sup> See id. See also Dodd-Frank Act Section 102(a)(6). The CFTC has not formally interpreted the “predominantly engaged in financial activities” standard, but the preamble to the CFTC’s final rule regarding the clearing exception for inter-affiliate swaps (discussed below) suggests that the CFTC will defer to the Federal Reserve on this interpretation.

- **Commodity Pool Operators and Commodity Trading Advisors.**
  - Although a financial end user is not subject to registration with the CFTC as an SD or MSP, it may be subject to registration with the CFTC in another capacity, such as a commodity pool operator (“CPO”) or commodity trading advisor (“CTA”).
  - Generally, a CPO includes any general partner, managing member or director of a commodity pool.<sup>12</sup>
    - With very limited exception,<sup>13</sup> a collective investment vehicle that directly or indirectly<sup>14</sup> enters into swaps, futures or other derivatives regulated by the CFTC is considered a commodity pool, even if the vehicle enters into such derivatives solely for hedging purposes.
    - Absent an exemption, a CPO is required to register as such with the CFTC. This registration requirement generally extends to the CPO of any commodity pool that has at least a single U.S. investor, or is formed in or operated from the United States.
    - The CPO of a private fund that enters into a limited amount of swaps may qualify for a de minimis exception from CPO registration. To claim this exemption, the CPO must make a notice filing with the National Futures Association for each entity for which it is claiming the exemption and disclose its reliance on the exemption to investors at or before sending subscription agreements to investors.<sup>15</sup>
  - In addition, any person who, for compensation or profit, engages in the business of advising others, either directly or through publications, writings or electronic media, as to the value of or the advisability of trading swaps, futures or other derivatives regulated by the CFTC, is considered a CTA.
    - Absent an exemption, a CTA is required to register as such with the CFTC.
    - Exemptions are available for CTAs that are also registered or exempt from registration as CPOs (for advice with respect to the commodity pools for which the CTA is registered or exempt), certain SEC-registered investment advisers and CTAs with 15 or fewer clients (counting funds (not their investors) as single clients, and, for foreign CTAs, counting only U.S. clients).

<sup>12</sup> A CPO is permitted, in certain cases, to delegate its responsibilities with respect to a commodity pool to another entity, such as the commodity pool's investment manager.

<sup>13</sup> In certain limited contexts, such as certain securitization vehicles and closely-held family investment vehicles, the CFTC has determined that a collective investment vehicle trading in CFTC-regulated derivatives is not a commodity pool.

<sup>14</sup> The CFTC has interpreted a commodity pool's feeder funds and subsidiary trading vehicles also to be commodity pools.

<sup>15</sup> For additional information regarding the de minimis CPO exemption and other aspects of the CFTC's regulation of CPOs, please refer to our March 7, 2012 Alert Memorandum entitled “CFTC Adopts Final Rules Requiring CPO Registration by Certain Hedge Fund and Private Equity Managers,” available at: [http://www.cgsh.com/cftc\\_adopts\\_final\\_rules\\_requiring\\_cpo\\_registration\\_by\\_certain\\_hedge\\_fund\\_and\\_private\\_equity\\_fund\\_managers/](http://www.cgsh.com/cftc_adopts_final_rules_requiring_cpo_registration_by_certain_hedge_fund_and_private_equity_fund_managers/).

### What Does It Mean to Clear a Swap?

- **Overview of Clearing.** To clear a swap, the counterparties to the swap must submit their respective sides of the swap to a derivatives clearing organization (“**DCO**”) either through a clearing broker (called a futures commission merchant or “**FCM**”) or directly (if the party is itself a member of the DCO), rather than maintaining a bilateral contract with each other. To accomplish this, since most end users are not self-clearing members, an end user typically must establish a clearing relationship with an FCM. In addition, for swaps entered into off of an exchange or swap execution facility (“**SEF**”), the end user or its counterparty may wish to enter into a cleared derivatives execution agreement (sometimes referred to as a “give up” agreement), which addresses the mechanics of submitting the swap for clearing and the consequences if the swap is rejected from clearing. The two counterparties to a cleared swap are not required to, but may, use the same FCM to clear the swap.
- **Margin Requirements.** Cleared swaps are subject to margin requirements established by the DCO, including daily exchanges of cash variation (or mark-to-market) margin and an upfront posting of cash or securities initial margin to cover the DCO’s (and FCM’s) potential future exposure to the end user in the event of its default. FCMs also typically establish additional “house” margin requirements beyond the amounts required by the relevant DCOs.
- **End Users May Choose the DCO.** Title VII provides that the counterparty to a swap transaction that is not an SD or MSP has the sole right to select the DCO for a transaction that is required to be cleared. Swap pricing may be affected by the DCO selected to clear the swap.
- **End Users May Choose to Clear Swap Transactions Not Subject to Mandatory Clearing.** An end user is entitled to elect to clear swap transactions that are not subject to mandatory clearing, at a DCO of such end user’s choice.

### Which Swaps Are Subject to Mandatory Clearing?

- **In General.** Title VII authorizes the CFTC, either upon application by a DCO or upon its own initiative, to require a designated swap or category of swaps to be cleared by a DCO. In 2012, the CFTC issued its first mandatory clearing determination for certain IRS and CDS.
- **IRS.** Very generally, the following IRS are subject to mandatory clearing:
  - Fixed-to-floating swaps;
  - Floating-to-floating swaps (also known as basis swaps);
  - Forward rate agreements; and
  - Overnight indexed swaps.

The mandatory clearing determination only applies to the IRS listed above in the following currencies: United States Dollar, Euro, Sterling or Yen.
- **CDS.** Very generally, the following CDS are subject to mandatory clearing:
  - Untranchetted CDS referencing the CDX.NA.IG and CDX.NA.HY indices; and
  - Untranchetted CDS referencing the iTraxx Europe, iTraxx Europe Crossover and iTraxx Europe High Volatility indices.



- The CFTC plans to make additional clearing determinations in the future. End users should consider establishing policies and procedures to monitor which swaps become subject to mandatory clearing.

#### **What Are the Exceptions or Exemptions to Mandatory Clearing?**

- **In General.** The CFTC has issued final rules detailing (i) a limited exception to the mandatory clearing requirement for a defined category of non-financial end users and (ii) an exemption to the mandatory clearing requirement for transactions between certain affiliated entities.
- **Swap Terminations.** Via no-action letter, the CFTC staff has clarified that the partial or full termination of an existing uncleared swap does not trigger the mandatory clearing requirement.<sup>16</sup>

#### **What Are the Criteria for the Non-Financial End-User Exception?**

- **Eligibility.** The CFTC has issued final rules outlining a limited exception to the mandatory clearing requirement for a defined category of non-financial end users. Both third-party and inter-affiliate trades may qualify for the exception. In order to qualify for the exception for a particular swap transaction:
  - **The Entity Entering into the Swap Must Not Be a Financial Entity.** To qualify for the exception, the particular entity entering into the swap must not be an SD, MSP or financial end user (as described above). Notably, even an entity within a corporate group that, on a group-wide basis, engages predominantly in non-financial activities may still be a financial entity depending on the activities of the particular entity in question (and those of its subsidiaries). However, there are certain cases where a financial entity is nevertheless eligible for the exception:
    - **Affiliates Acting as Agents for Non-Financial End Users.** The end-user exception provides that an affiliate of a non-financial end user may be permitted to use the exception so long as it acts “on behalf of the [non-financial end user] and as an agent.” As a result, financial end users acting on behalf of, and as an agent for, a non-financial end user affiliate may make use of the end-user exception. An SD or MSP, however, may not make use of the end-user exception, even if it acts on behalf of and as an agent for a non-financial end user.
    - **Captive Finance Entities.** A captive finance entity is considered to be a non-financial entity eligible to make use of the end-user exception if (i) its primary business is providing financing, (ii) it uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, (iii) 90 percent or more of such exposures arise from financing that facilitates the purchase or lease of products and (iv) 90 percent or more of such products are manufactured by the entity’s parent company or another subsidiary of the parent company.

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<sup>16</sup> See CFTC Letter No. 13-02, Comm. Fut. L. Rep. (CCH) ¶32,560 (Mar. 20, 2013). The CFTC staff has also provided no-action relief from the clearing requirement for swaps that result from multilateral compression exercises, subject to certain conditions. See CFTC Letter No. 13-01, Comm. Fut. L. Rep. (CCH) ¶32,559 (Mar. 18, 2013).



- **Small Financial Institutions.** The CFTC has exempted certain small financial institutions from the definition of “financial entity.” Small financial institutions include those banks, savings associations, farm credit system institutions and credit unions with total assets of \$10 billion or less on the last day of such person’s most recent fiscal year. The CFTC has also provided no-action relief for certain small bank holding companies, savings and loan holding companies and community development financial institutions.<sup>17</sup>
- **Treasury Affiliates, Cooperatives and Foreign Sovereigns.** As described below, certain “treasury affiliates,” cooperatives and foreign sovereigns are eligible for relief from the clearing requirement, even if they are technically defined as “financial entities.”
- **The Swap Must Be Used to Hedge or Mitigate Commercial Risk.** The CFTC has defined “hedging or mitigating commercial risk” to include swaps that are economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, excluding any transactions that are in the nature of speculation, investing or trading or that are used to hedge another swap, unless that other swap is itself used to hedge or mitigate commercial risk.
  - The CFTC has indicated that commercial risk does not refer only to the risk of the end user itself. For example, the parent entity in a corporate group that is itself eligible for the end-user exception may make use of the exception when it enters into a swap for the purpose of hedging the aggregate commercial risk of affiliates within the corporate enterprise.
  - A swap may also be deemed to hedge or mitigate commercial risk if the swap qualifies for hedging treatment under Financial Accounting Standards Board Accounting Standards Codification Topic 815 (“Derivatives and Hedging”) or Governmental Accounting Standards Board Statement 53 (“Accounting and Financial Reporting for Derivative Instruments”).
- **The End User Must Make an Annual Filing with an SDR or the CFTC.** In order for a non-financial end user to rely on the end-user exception for a particular swap transaction, one of the parties to the swap must provide either a swap data repository (“**SDR**”) or the CFTC with information regarding “how the end user generally meets its financial obligations associated with entering into an uncleared swap.”
  - The CFTC has indicated that this requirement would be satisfied if, on at least an annual basis, the end user provides, or causes to be provided, certain specified information to an SDR or the CFTC, including whether the entity generally meets its financial obligations associated with its swaps by (i) a written credit support agreement, (ii) pledged or segregated assets, (iii) a written third-party guarantee, (iv) its own available resources or (v) some other means.
  - The SDRs currently registered with the CFTC include BSDR LLCC, DTCC Data Repository, ICE Trade Vault LLC and the Chicago Mercantile Exchange.
  - If an end user does not make an annual filing, it must provide its counterparty with information regarding how it meets its financial obligations each time it enters into a

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<sup>17</sup> See CFTC Letter No. 16-01 (Jan. 8, 2016), available at: <http://www.cftc.gov/idc/groups/public/@llettergeneral/documents/letter/16-01.pdf>, and CFTC Letter No. 16-02 (Jan. 8, 2016), available at: <http://www.cftc.gov/idc/groups/public/@llettergeneral/documents/letter/16-02.pdf>.

transaction in reliance on the end-user exception, although it can generally provide this information via relationship-wide documentation.

- **SEC Filers Must Obtain Certain Board Approvals.** If a non-financial end user is, or is controlled by an entity, required to file disclosures with the SEC under the Exchange Act, such end user cannot make use of the non-financial end user clearing exception unless an “appropriate” committee of the board of directors of the entity (which could be the board itself) has approved the decision not to clear the swap. If more than one entity in an end user’s group enters into swaps, an appropriate committee of the board of directors of each entity must approve the decision to rely on the end-user exception (or, under certain conditions, delegate responsibility for such approval to an appropriate committee of the board of directors of a parent company).
  - **Annual Committee Resolution Approving Use of End-User Exception.** The board of directors of an end user does not need to approve each swap transaction with respect to which the end user elects the clearing exception. Rather, the CFTC has indicated that an annual certification from the relevant committee of an end user’s board of directors that it has reviewed and approved the decision to utilize the exception will suffice.
  - **Board Approval of a Swap Policy.** As a corporate governance matter, the appropriate board committee may approve a swap policy that contains sufficiently detailed parameters to demonstrate that the board committee has exercised appropriate oversight of management’s authority to clear or not clear certain swaps. For example, the policy could set limits on the types of counterparties or types of swaps that are pre-approved for the exception and require that any transaction outside those parameters be specifically approved by the committee. The committee could also identify factors that are relevant to the decision not to clear a swap, which could include credit risk analysis, the end user’s overall hedging policies, the uniqueness of the swap, margin requirements, accounting and tax considerations.
  - **Choosing an Appropriate Committee.** The CFTC has indicated that a board committee would be appropriate for these purposes if it is specifically authorized to review and approve the end user’s decision to enter into swaps. While the CFTC provides SEC filers and their controlled subsidiaries with reasonable discretion to determine the appropriate committee, for most end users, it is expected that the audit committee (or other committee responsible for oversight of treasury activity) would perform this role.
- **Reporting Obligation for Each Swap Transaction Relying on End-User Exception.** For each swap between an end user and an unaffiliated entity in which the end user relies on the exception, the reporting counterparty<sup>18</sup> is required to provide the following information to an SDR or the CFTC: (1) whether the end-user exception has been elected; (2) which party is the electing counterparty; and (3) whether the electing counterparty has already provided the information discussed above through an annual filing.
  - **End Users Rarely Are the Reporting Counterparty.** If the end user’s counterparty is an SD or MSP, the obligation to report this election to an SDR or the CFTC falls upon such SD or MSP counterparty.
  - **Where Both Counterparties Are Not SDs/MSPs, and Only One Counterparty is a U.S. Person, the U.S. Person is the Reporting Counterparty.** If a non-financial end user enters

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<sup>18</sup> This memorandum provides a more thorough discussion of reporting obligations in the section entitled “Will End Users Be Required to Report Their Swap Transactions?”.

- into a swap with a financial entity that is not a U.S. person and not an SD or MSP, then the end user has the reporting obligation, unless otherwise agreed by contract.
- **Inter-Affiliate Trades.** Under no-action relief issued by the CFTC staff (the “**Inter-Affiliate Reporting No-Action Letter**”),<sup>19</sup> end users need not report the information relating to the end-user exception for swaps with certain affiliates, subject to conditions described in “Are End Users Required to Report Inter-Affiliate Transactions?” below. If a non-financial end user is or is controlled by an entity required to file disclosures with the SEC under the Exchange Act, Title VII still requires approval of the use of the end-user exception by the end user’s board or appropriate committee, and therefore board resolutions may still be required for end users that only trade with affiliates.
  - **“Reasonable Basis” Requirement.** If the end user is not the reporting counterparty, then the reporting counterparty must have a “reasonable basis to believe” that the end user electing the exception is entitled to do so. The CFTC has not provided an explicit standard for having “reasonable basis” to believe, but has stated that reasonableness depends on the applicable facts and circumstances. The CFTC has clarified, however, that the standard does not require independent investigation by the reporting counterparty of information or documentation provided by an end user. As long as the reporting counterparty has obtained information, documentation or a representation that on its face provides a reasonable basis to conclude that the end user qualifies for the exception, then, absent facts to the contrary, no further investigation would be necessary.
  - **No-Action Relief for Treasury Affiliates.** The CFTC staff has issued no-action relief from mandatory clearing for certain “treasury affiliates” that undertake hedging activities on behalf of affiliates within a corporate group.<sup>20</sup>
    - **Eligible Treasury Affiliates.** Only certain treasury affiliates are eligible for the no-action relief.
      - **Wholly-Owned by a Non-Financial End User.** A treasury affiliate is an entity that is (A) directly, wholly-owned<sup>21</sup> by a non-financial end user or another eligible treasury affiliate (its “**non-financial parent**”), and (B) is not indirectly majority-owned<sup>22</sup> by a financial end user.
      - **Ultimate Parent.** The treasury affiliate’s ultimate parent<sup>23</sup> cannot be a financial end user.

<sup>19</sup> See CFTC Letter No. 13-09, Comm. Fut. L. Rep. (CCH) ¶32,590 (Apr. 5, 2013).

<sup>20</sup> See CFTC Letter No. 14-144, Comm. Fut. L. Rep. (CCH) ¶33,359 (Nov. 26, 2014). This letter amended earlier no-action relief issued in 2013. See CFTC Letter No. 13-22, Comm. Fut. L. Rep. (CCH) ¶32,639 (Jun. 4, 2013).

<sup>21</sup> An entity is wholly-owned by a person if the person, directly or indirectly, holds 100% of the equity securities of the entity, or the right to receive upon dissolution, or the contribution of, 100% of the capital of a partnership of the entity, and the entity’s financial results are included in the financial statements of the person as prepared on a consolidated basis under Generally Accepted Accounting Principles (“**GAAP**”) or International Financial Reporting Standards (“**IFRS**”).

<sup>22</sup> An entity is majority-owned by a person if the person, directly or indirectly, holds a majority of the equity securities of the entity, or the right to receive upon dissolution, or the contribution of, a majority of the capital of a partnership of the entity, and the entity’s financial results are included in the financial statements of the person as prepared on a consolidated basis under GAAP or IFRS.

<sup>23</sup> For purposes of the no-action relief, a treasury affiliate’s ultimate parent is the top most, direct or indirect, majority owner of the person in the corporate hierarchy of which the person is a member.

- **Limited Financial Activities.** The treasury affiliate must be a financial end user solely as a result of acting as principal to swaps with, or on behalf of, one or more of its related affiliates, or providing other services that are financial in nature to such related affiliates. Certain enumerated types of financial institutions, funds and employee benefit plans do not qualify as treasury affiliates.
- **Not Affiliated with an SD or MSP.** The relief is not available to a treasury affiliate that is, or is affiliated with, an SD, MSP, security-based swap dealer or major security-based swap participant. The relief also is not available to a treasury affiliate that is a nonbank financial company that has been designated as systemically important by the Financial Stability Oversight Council, although the treasury affiliate may be affiliated with such a company so long as the treasury affiliate does not provide any services to that company.
- **Eligible Swap Transactions.** Even if an entity qualifies as a treasury affiliate, not all swap transactions are eligible for the relief from mandatory clearing.
  - **The Swap Must Be Used to Hedge or Mitigate Commercial Risk.** In order to rely on the relief, the swap transaction must be used to hedge or mitigate the commercial risk of the corporate group. This requirement is explained more fully above.
  - **No Transactions with Affiliated Financial End Users.** The treasury affiliate may not, directly or indirectly, enter into swaps with or on behalf of any affiliate that is a financial end user, except a financial end user that qualifies as an eligible treasury affiliate.
  - **Risk Management Program.** Each swap transaction relying on this relief must be subject to a centralized risk management program.
- **Reporting.** One counterparty to the swap transaction must report the election of the relief to an SDR or the CFTC, along with the board certification and information regarding how the entity meets its financial obligations, which is also required for reliance on the end-user exception and inter-affiliate exemptions discussed herein.
- **Cooperative Exemption.** The CFTC has exempted certain cooperatives, which otherwise would not qualify for the end-user exception, from the clearing requirement. This exemption is subject to conditions similar to those that apply to the end-user exception. The exemption is available to a cooperative whose members are non-financial entities, small financial institutions (as described above) or cooperatives whose members fall into one of the first two categories.
- **Treatment of Foreign Sovereigns.** The CFTC has stated that foreign governments, foreign central banks and international financial institutions are not subject to mandatory clearing. This exclusion does not apply to sovereign wealth funds or similar entities that, based on their activities, would likely be considered financial end users. As a result, sovereign wealth funds must be analyzed like any non-sovereign entity.

**What Are the Criteria for the Inter-Affiliate Exemption from Mandatory Clearing and Trading?**

- **In General.** The CFTC has issued rules that exempt from mandatory clearing certain swaps between affiliated entities under common majority ownership whose financial statements are consolidated with each other,<sup>24</sup> whether or not such entities qualify as non-financial end users or use swaps to hedge or mitigate commercial risk.
- **Eligibility Criteria.** To be eligible for the exemption, the affiliates must:
  - document their trading relationship consistent with the swap trading relationship documentation requirements discussed below or, where both counterparties are not SDs/MSPs, document in writing all terms governing the trading relationship between the affiliates;
  - establish a centralized risk management program with respect to the inter-affiliate swaps;
  - report the election of the exemption to an SDR or the CFTC, along with the board certification and information regarding how the entity meets its financial obligations, as is also required for reliance on the end-user exception (discussed above); and
  - satisfy the outward-facing swaps condition, described below.
- **Treatment of Outward-Facing Swaps Condition.** In order to qualify for the exemption, both affiliates to the swap transaction must generally, when entering into swaps with unaffiliated counterparties, either:
  - comply with the CFTC's mandatory clearing requirement under Title VII;
  - comply with an exception or exemption from the CFTC's mandatory clearing requirement under Title VII;
  - comply with the requirements for clearing swaps under a foreign jurisdiction's clearing requirement that is comparable to, and as comprehensive as but not necessarily identical to, the CFTC's clearing requirement under Title VII, as determined by the CFTC;
  - comply with an exception or exemption under a foreign jurisdiction's clearing requirement; or
  - clear such swap through a DCO or a clearing organization that is subject to supervision by appropriate government authorities in the home country of the clearing organization and that has been assessed to be in compliance with certain principles for financial market infrastructures published by the International Organization of Securities Commissions ("IOSCO").
- **Time-Limited Alternative Compliance Framework.** Given that the clearing requirement in the United States has taken effect before clearing requirements in other jurisdictions, the CFTC has recognized that it may be difficult for non-U.S. affiliates to meet the outward-facing swaps condition discussed above. As a result, the CFTC has provided the time-limited alternative compliance framework described below, which is currently scheduled to remain in effect until December 31, 2016.
  - **Affiliates Located in the European Union ("EU"), Japan or Singapore.** Swaps between a U.S. affiliate and an affiliate located in the EU, Japan or Singapore are deemed to have met the outward-facing swaps condition if (i) each affiliate pays and collects full variation margin daily on all swaps entered into by the affiliate with unaffiliated counterparties, (ii) each affiliate

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<sup>24</sup> Affiliates are eligible for this exemption if one counterparty directly or indirectly holds a majority ownership interest in the other counterparty or if a common entity directly or indirectly holds a majority ownership interest in each counterparty.

- pays and collects full variation margin daily on all swaps entered into with eligible affiliate counterparties or (iii) the affiliates' common majority owner is not a financial entity and neither affiliate is affiliated with an SD or MSP.
- **Affiliates Not Located in the EU, Japan or Singapore.** Swaps between a U.S. affiliate and an affiliate that is not located in the EU, Japan or Singapore are deemed to have met the outward-facing swaps condition if (i) the aggregate notional value<sup>25</sup> of swaps entered into by the affiliate counterparty located in the United States with affiliate counterparties outside of the United States, the EU, Japan or Singapore that are required to be cleared does not exceed 5% of the aggregate notional value of all of the U.S. affiliate counterparty's swaps that are required to be cleared and (ii) either the affiliate located outside the U.S., EU, Japan and Singapore pays and collects full variation margin daily on all swaps it enters into with unaffiliated counterparties or both affiliates pay and collect full variation margin daily on all their swaps with eligible affiliate counterparties.
  - Generally speaking, because of the additional conditions to the inter-affiliate exemption, and because of the additional reporting obligations (discussed below), an entity eligible for the non-financial end-user exception for a swap with an affiliate will find reliance on the non-financial end-user exception more straightforward.

#### **Are There Restrictions on Trading Imposed on End Users?**

- **In General.** Unless subject to an exception, end users are prohibited from entering into OTC swaps directly with their counterparties if either of the following two conditions is true:
  - Either party is not an ECP; or
  - The swap is subject to the mandatory clearing requirement and is made "available to trade" by a designated contract market ("DCM") (i.e., a futures exchange) or a SEF.
- **ECP Trading Requirement.**
  - **In General.** Under Title VII, any swap transaction with a person other than an ECP must be entered into on, or subject to the rules of, a DCM.
  - **Who is an ECP?** Generally speaking, for an unregulated corporation, partnership or other entity to qualify as an ECP, its total assets must exceed \$10 million or, if it is entering into the swap in connection with its business or to manage risk, \$1 million. Commodity pools (including many private funds) are subject to heightened ECP standards, including a "look-through" to underlying investors in certain circumstances. The term "ECP" also includes several defined classes of institutions (e.g., banks, insurance companies, registered investment companies, pension plans, governmental entities, broker-dealers and FCMs) and natural persons that meet certain asset and other requirements.<sup>26</sup>
  - **Must All Swap Guarantors be ECPs?** The CFTC's position is that any guarantee of a swap is, itself, a swap. As a result, each guarantor of a swap must be an ECP in order not to be

<sup>25</sup> In each instance, the notional value is measured in U.S. dollar equivalents and calculated for each calendar quarter.

<sup>26</sup> For certain purposes, ECPs also include financial institutions, insurance companies, commodity pools, governmental entities, broker-dealers, FCMs, floor brokers and floor traders acting as a broker or performing an equivalent agency function on behalf of another ECP. In addition, ECPs also include such entities, along with investment advisers, commodity trading advisors and similarly regulated foreign persons, who are acting as investment manager or fiduciary for another ECP and who are authorized by that person to commit that person to the relevant transaction.



subject to the prohibition on entering into OTC swaps discussed above.<sup>27</sup> While this requirement may not be particularly onerous for most swap guarantors, it may present an issue in the secured financing context, where multiple affiliates (including those with minimal assets) may guarantee secured obligations that include not just loan obligations, but obligations under related IRS or other swaps. If a non-ECP guarantees a swap, the non-ECP guarantor could face enforcement action, the guarantee may be unenforceable (depending on applicable state law) and the SD counterparty, if any, could face enforcement action for failure to verify the ECP status of the guarantor.<sup>28</sup> On February 15, 2013 the Loan Syndications and Trading Association issued a market advisory describing how parties can draft their secured loan agreements to ensure that non-ECPs do not guarantee any swap obligations.<sup>29</sup> Except in the context of commodity pools, an ECP may also provide a keepwell to confer ECP status on an entity that would otherwise be a non-ECP guarantor.

- **Trading Requirement for Cleared Swaps.**

- **In General.** Swaps subject to the mandatory clearing requirement are required to be traded on a DCM or SEF unless the swap is not made “available to trade” by a DCM or SEF.
- **When Is a Swap Made “Available to Trade”?** A SEF or DCM may determine whether a swap that it lists or offers for trading is made “available to trade” and submit that determination to the CFTC for approval or certification. In making such a determination, a SEF or DCM must consider: the presence of willing buyers and sellers; the frequency or size of transactions; the trading volume; the number and types of market participants; the bid/ask spread; and/or the usual number of resting firm or indicative bids and offers. Swaps currently made available to trade include (i) liquid tenors of United States Dollar, Euro and Sterling LIBOR fixed-to-floating IRS and (ii) 5-year untranching CDS referencing the on-the-run and most recent off-the-run CDX and iTraxx indices.<sup>30</sup>
- **What is a SEF?** Title VII defines a SEF to include any trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants. SEFs are required to register with the CFTC, act as self-regulatory organizations and are subject to comprehensive regulation by the CFTC. Order book, request for quote (“RFQ”) and inter-dealer broker platforms qualify as SEFs, but systems operated by a single dealer do not. A SEF is required to offer order book trading functionality for all swaps it lists.
- **What is the Trading Requirement?** Generally, a swap that has been made “available to trade” must be executed on (i) a DCM’s centralized market, (ii) on a SEF through its order book or (iii) on a SEF through its RFQ functionality, provided that an RFQ must be sent to at least three unaffiliated recipients. This requirement can make it more difficult for an end user to execute swaps that have been made “available to trade” on a SEF or DCM without suffering adverse price effects from exposing its trading interest to a larger number of other market participants.

<sup>27</sup> See CFTC Interpretative Letter No. 12-17, Comm. Fut. L. Rep. (CCH) ¶32,408 (Oct. 12, 2012).

<sup>28</sup> See “How Does Title VII Change the Way Swap Transactions Are Documented” below.

<sup>29</sup> See Updated Market Advisory: Swap Regulations’ Implications for Loan Documentation, The Loan Syndications and Trading Association (Feb. 15, 2013). As noted in the advisory, whether the ECP requirement also applies to a pledgor pledging collateral to secure an affiliate’s swap is uncertain.

<sup>30</sup> Made Available to Trade Determinations are available at <http://sirt.cftc.gov/sirt/sirt.aspx?Topic=%20SwapsMadeAvailableToTradeDetermination>.



- **SEF Membership.** Generally, an end user may trade on a SEF through a broker that is a member of the SEF, or directly on the SEF as a member. An end user who is a member of a SEF is subject to additional recordkeeping requirements (discussed below).
- **Are There Any Exceptions to the Trading Requirement for Cleared Swaps?**
  - **Block Trades.** The CFTC permits block-sized swaps to be executed off of a SEF or DCM through any means of interstate commerce. Only the largest trades qualify as block trades.<sup>31</sup>
  - **Swaps Exempt/Excepted from Mandatory Clearing.** Swaps excepted or exempted from mandatory clearing are not covered by the trading requirement.
  - **Inter-affiliate Swaps.** Swaps that are subject to the inter-affiliate exemption from the clearing requirement are not subject to the trading requirement. Additionally, the CFTC staff has provided time-limited no-action relief from the trading requirement for swaps between eligible affiliates that otherwise do not meet the conditions of the inter-affiliate exemption from the clearing requirement.<sup>32</sup>
  - **Package Transactions.** A package transaction is a transaction (i) involving two or more instruments, at least one of which is a swap subject to the trading requirement, (ii) that is priced as a single transaction and (iii) where execution of each instrument is contingent upon the execution of all other instruments. The CFTC has provided time-limited no-action relief from the trading requirement for swaps that are a part of specified types of package transactions.<sup>33</sup>

#### **Must End Users Exchange Collateral with Respect to Their Uncleared Swaps?**

- **In General.** Title VII requires SDs and MSPs to satisfy initial and variation margin requirements for uncleared swaps. Margin requirements for uncleared swaps are generally higher than the margin requirements established by DCOs in respect of cleared swaps.
- **Who Sets Margin Requirements?**
  - The U.S. federal banking regulators (called the “**Prudential Regulators**”)<sup>34</sup> are responsible for setting margin requirements for SDs and MSPs that are banks, and the CFTC is responsible for setting margin requirements for SDs and MSPs that are not banks. The CFTC and the Prudential Regulators have largely harmonized their respective margin requirements in their final rules.
  - In an effort to achieve harmonization across jurisdictions and regulators, the Basel Committee on Banking Supervision (“**BCBS**”) and IOSCO have issued international standards on margin requirements for swaps that are not centrally cleared,<sup>35</sup> which are generally consistent with the rules adopted by the Prudential Regulators and the CFTC.
- **Margin Requirements for Non-Financial End Users.** The margin requirements noted above do not require a minimum amount of margin for uncleared swaps involving non-financial end users, although

<sup>31</sup> Initial minimum block sizes are set forth in CFTC Regulations Part 43 Appendix F. The CFTC has also provided time-limited no-action relief permitting block trades to be executed on a SEF, other than through the SEF’s order book functionality. See CFTC Letter No. 15-60, Comm. Fut. L. Rep. (CCH) ¶32,584 (Nov. 2, 2015).

<sup>32</sup> See CFTC Letter No. 15-62, Comm. Fut. L. Rep. (CCH) ¶33,590 (Nov. 17, 2015).

<sup>33</sup> See CFTC Letter No. 15-55, Comm. Fut. L. Rep. (CCH) ¶32,568 (Oct. 14, 2015).

<sup>34</sup> The Prudential Regulators are the Federal Reserve, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Farm Credit Administration and the Federal Housing Finance Agency.

<sup>35</sup> See “Margin requirements for non-centrally-cleared derivatives,” BCBS-IOSCO (March 2015).

counterparties can bilaterally agree to collect and post margin.<sup>36</sup> SDs and MSPs are required to notify end users of their option to require that initial margin posted voluntarily to the SD or MSP be segregated at an unaffiliated custodian.

- **Margin Requirements for Financial End Users.** The Prudential Regulators and CFTC require that initial and variation margin be exchanged between an SD or MSP and a financial end user.
  - A financial end user is not subject to initial margin requirements, unless the aggregate notional amount of uncleared swaps, uncleared security-based swaps, foreign exchange swaps and foreign exchange forwards outstanding for the financial end user and its affiliates exceeds \$8 billion on a daily average basis for June, July and August of the prior calendar year.
  - An SD or MSP can set potential future exposure thresholds of up to \$50 million before exchange of initial margin is required, but no threshold is permitted with respect to variation margin. The initial margin threshold applies on a consolidated basis across an SD or MSP and its affiliates and the SD's or MSP's counterparty and its affiliates.
  - Initial margin and variation margin transfers may be subject to an aggregate minimum transfer amount of up to \$500,000.
  - Initial margin required to be exchanged must be segregated at an unaffiliated custodian. Initial margin posted by an end user in excess of the required amount need not be segregated, but an end user has the right to require that an SD or MSP segregate such excess initial margin at a custodian.
- **Sovereign Entities and International Organizations.** The term financial end user does not include foreign sovereign entities, multilateral development banks or the Bank of International Settlements.
- **Foreign Exchange Swaps and Forwards.** The margin requirements do not apply to foreign exchange swaps and foreign exchange forwards covered by the exemption issued by the Secretary of the Treasury, although Federal Reserve supervisory guidance requires large banks to exchange variation margin for such transactions.
- **Cross-Border Application.** The Prudential Regulators have finalized, and the CFTC has proposed, rules addressing the cross-border application of margin requirements. These rules would apply the margin rules more broadly than would the CFTC's cross-border guidance (discussed below). Very generally, the margin rules would apply to all swaps between a financial end user and an SD or MSP, except for swaps between a non-U.S. financial end user and a non-U.S. SD or MSP whose ultimate parent is a non-U.S. person, where neither counterparty is guaranteed by a U.S. person.
- **Timing for Compliance.** Variation margin requirements will become effective in September 2016 for the most active market participants and March 2017 for all others. Initial margin requirements will become effective in annual phases from September 2016 through September 2020, with the most active market participants becoming subject to initial margin requirements soonest.

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<sup>36</sup> The "financial end user" definition that applies for purposes of margin rules differs somewhat from the definition that applies for other purposes under Title VII. In particular, the margin rules' definition replaces the "catch-all" prong for entities predominantly engaged in activities that are financial in nature with several additional categories covering specified entities subject to state or federal financial licensing requirements and several types of investment and trading vehicles.

### **Must End Users Report Their Swap Transactions?**

- **In General.** Title VII requires that all swap transactions that were in existence as of July 21, 2010 (the date Title VII was enacted), or entered into after that date, be reported to an SDR or, if no SDR accepts the relevant swap data, the CFTC. This requirement applies to end users, although the CFTC has issued no-action relief regarding certain inter-affiliate swaps entered into by end users.
- **Public Reporting.** Title VII requires that swap transaction and pricing data be reported to the public in real-time as soon as technologically practicable after execution, subject to (i) certain delays for block trades as described below and (ii) an exception for swap transactions (such as inter-affiliate swaps) that are not “arm’s length.” The parties’ identities are not made public.
- **Regulatory Reporting.** Title VII also requires that all relevant information about every swap transaction be reported to an SDR or the CFTC for the entire life of the transaction. For each swap transaction, the reporting party must report (i) “creation” data composed of the primary economic terms of the swap transaction and all of the terms of the swap in the legal confirmation and (ii) “continuation” data documenting all of the lifecycle events of the swap transaction (e.g., a daily snapshot of all primary economic terms data, including any changes that have occurred since the previous snapshot) and the valuation of the swap transaction. Such data is maintained for regulatory purposes and is not made public.
- **Reporting Delays for “Block Trades.”** The CFTC has provided for certain delays in real-time public dissemination of swap transaction data for block trades. Block trade thresholds and reporting delays differ depending on the asset class (or sub-asset class swap category), method of execution and status of the parties. If a swap exceeds the applicable block trade threshold, the public reporting of data on that swap is delayed for at least 15 minutes and, in some cases, significantly longer.<sup>37</sup>

### **Who Is Responsible for Reporting Swap Transaction Data?**

- **End Users Are Not Usually Responsible for Reporting.** In general, end users are not responsible for reporting most of their swap transactions.
  - In a transaction in which one of the parties is an SD or MSP and the other is not, the SD or MSP is responsible for satisfying the reporting obligation (even if the SD or MSP is a non-U.S. person).
  - In a transaction in which one of the parties is a financial end user and the other is a non-financial end user, the financial end user is responsible for satisfying the reporting obligation (unless the financial end user is a non-U.S. person, in which case the U.S. person is responsible for reporting).
  - In a transaction in which both parties are non-financial end users, the counterparties are to agree as a term of the transaction as to which counterparty is the reporting party (unless one of the non-financial end users is a non-U.S. person, in which case the U.S. person is responsible for reporting).
- **End Users Are Responsible for Reporting Transactions with Certain Non-U.S. Counterparties.** The CFTC has stated that, in the case of a swap between a U.S. and a non-U.S. person, in which neither party is an SD or MSP, the U.S. person is responsible for reporting, regardless of the statuses of the parties. Foreign financial institutions that have not registered as SDs may agree by contract to

<sup>37</sup> See 78 Fed. Reg. 32,866 (May 31, 2013) (“**Block Trade Final Rule**”). Time delays for public dissemination are set forth in CFTC Regulations Part 43 Appendix C. Initial minimum block sizes are set forth in CFTC Regulations Part 43 Appendix F.

report swaps on behalf of their U.S. end user counterparties, although a U.S. end user ultimately remains responsible for ensuring that the swaps are reported.

### **Are End Users Required to Report Inter-Affiliate Transactions?**

- **No-Action Relief from Reporting End-User Inter-Affiliate Transactions.** The CFTC staff has issued no-action relief to end users for regulatory reporting obligations with respect to certain inter-affiliate swaps (including historical swap reporting and reporting relating to the end-user exception). Public reporting requirements, which apply to all trades that are “arms’ length,” are not the subject of the Inter-Affiliate Reporting No-Action Letter. The no-action relief is not time-limited.
- **Conditions to the Inter-Affiliate Reporting No-Action Letter.** Each aspect of the relief only applies to bilateral, uncleared OTC swaps where neither counterparty is an SD, MSP or an affiliate of either. The relief includes the following conditions:
  - **100% Commonly Owned Affiliates – New Swaps.** The no-action relief from regulatory reporting and end-user exception reporting applies to swaps between a counterparty that 100% owns the other counterparty or between counterparties that are 100% commonly owned (directly or indirectly) by a party that reports its financial statements on a consolidated basis.
  - **Majority Commonly Owned Affiliates – New Swaps.** For swaps between a counterparty that owns a majority interest in the other counterparty or between counterparties that are majority commonly owned (directly or indirectly) by a party that reports its financial statements on a consolidated basis, the no-action relief allows a party only to report the information required under the regulatory reporting rule and the end-user exception rule on a quarterly basis (no more than 30 days after the entity’s fiscal quarter), as long as public reporting requirements do not apply to the individual swaps. (As noted above, public reporting does not apply to trades that are not “arms’ length.”)
  - **All Affiliates – Historical Swaps.** The no-action relief from historical reporting applies to any swaps between affiliates, whether 100% or majority owned or commonly owned.
  - **All Outward-Facing Trades Must Be Reported.** To be eligible for this relief, each affiliated end user must ensure that all of its trades with unaffiliated counterparties are reported. This condition requires reporting even for trades that would not otherwise be subject to reporting because, for example, neither party is a “U.S. person” (as discussed in more detail below). Public reporting, regulatory reporting, historical reporting and end-user exception reporting each apply for all swaps with unaffiliated counterparties, even swaps that are unrelated to the inter-affiliate swap subject to the relief. End users, particularly those with inter-affiliate trades between U.S. and non-U.S. affiliates, must consider whether additional reporting obligations imposed by this condition make relying on the no-action relief more burdensome than reporting their inter-affiliate transactions.
- **Recordkeeping Obligations Still Apply.** Any end user relying on this relief must still retain records of all swaps as required by the regulatory reporting and historical reporting rules.

### **If an End User Is Not a Reporting Party, Does It Have Any Reporting Obligations?**

- **End Users Must Obtain a Legal Entity Identifier.** Even in those situations where end users are not responsible for reporting swap data to the relevant data repository, the CFTC requires that each counterparty to a swap be identified in all recordkeeping and all swap data reporting by means of a single legal entity identifier. As a result, end users must obtain a legal entity identifier for each legal

entity entering into derivatives transactions and must periodically update the information associated with their identifiers.<sup>38</sup>

- **End Users May Need to Provide Consent.** In addition to obtaining a legal entity identifier, an end user may be required, under applicable non-U.S. laws, to consent to having its data reported to the relevant SDR by its SD or MSP counterparty.

#### **How Does Title VII Change the Way Swap Transactions Are Documented?**

- **In General.** Under Title VII, SDs and MSPs entering into swap transactions are subject to a host of regulations, some of which require them to make and receive certain representations and agreements from their counterparties and receive certain information about their counterparties.
- **SDs and MSPs Are Subject to External Business Conduct Standards That Have an Impact on End Users.** Title VII provided the CFTC with mandatory and discretionary rulemaking authority to impose business conduct standards on SDs and MSPs. Although these standards relate to the conduct of SDs and MSPs, certain of the requirements impose indirect obligations on end users or require the satisfaction of certain pre-execution requirements.
  - **End Users Are Typically Asked to Make Certain Representations to SD and MSP Counterparties.**
    - **Know Your Counterparty.** SDs are required to have policies and procedures reasonably designed to obtain and retain a record of essential facts concerning a known counterparty to a swap transaction. As such, SDs typically ask end users for (i) facts required to comply with applicable law and to ensure compliance with the SD's internal credit and operational risk management policies and (ii) information regarding the authority of any person acting for the counterparty.
    - **True Name and Owner.** SDs and MSPs are required to obtain and retain a record of the true name and address of the counterparty, guarantors, underlying principals and any persons exercising control with respect to the positions of such counterparty.
    - **Eligibility Verification.** Before entering into a swap transaction, an SD or MSP must (i) verify that its counterparty is an ECP and (ii) determine whether its counterparty is a Special Entity or eligible to elect to be treated as a Special Entity.
    - **Suitability.** The CFTC requires that an SD have a reasonable basis to believe that any swap or trading strategy involving swaps that it recommends to a counterparty is suitable for such counterparty. Thus, recommendations trigger a duty by SDs to undertake "reasonable diligence" to understand the "risks and rewards" of a swap and to have a "reasonable basis" to believe the swap is "suitable" to the counterparty's needs.
      - **Safe Harbor.** For an end user that is not a Special Entity, suitability requirements are met in circumstances where (i) the end user or its representative represents it is exercising independent judgment and (ii) the SD represents it is not evaluating the suitability of any recommendation.
      - **Impact on End Users.** In order to rely on the safe harbor, an SD typically requests that an end user or its representative represent that it is exercising independent judgment and is capable of evaluating the SD's recommendations.

<sup>38</sup> Legal entity identifiers may be obtained online at <https://www.ciciutility.org>.

- **Additional Obligations Involving Special Entities.** Additional obligations apply to SDs or MSPs transacting with Special Entities. For more information, please refer to our April 12, 2012 Alert Memorandum entitled “CFTC Adopts External Business Conduct Standards.”<sup>39</sup>
- **SDs and MSPs Must Provide End Users with Certain Information.**
  - **Scenario Analysis.** For swaps not subject to Title VII’s mandatory trading requirement, an SD must offer to provide a scenario analysis to end users and must provide the analysis if the end user requests it. The SD is required to design the scenario analysis in consultation with the end user and must also disclose all material assumptions and calculation methodologies used to perform the analysis (although it is not required to disclose any confidential, proprietary information about any model used to prepare the analysis).
  - **Clearing.** If a swap is subject to mandatory clearing, an SD or MSP is required to notify an end user counterparty of its right to select the DCO. If the swap is not subject to mandatory clearing, the SD or MSP is required to notify such counterparty of its right to elect to require the swap to be cleared and to select the DCO.
  - **Certain Disclosures.** SDs and MSPs must provide end users with information about the following:
    - material risks;
    - material contract characteristics of the swap transaction;
    - material incentives and conflicts of interest (including pre-trade mid-market marks); and
    - daily marks for uncleared swaps and a notification that an end user counterparty has the right to receive the DCO’s daily mark for a cleared swap.
- **Swap Trading Relationship Documentation.** CFTC rules require that SDs and MSPs, but not end users, comply with certain swap trading relationship documentation requirements. These rules require that SDs and MSPs establish policies and procedures reasonably designed to ensure that they execute written (electronic or otherwise) swap trading relationship documentation with their counterparties that includes, among other items, all terms governing the swap trading relationship and all credit support arrangements.
  - **Requirement for Financial End Users to Agree to a Valuation Process.** For swap transactions with financial end users, the financial end user and its SD or MSP counterparty must have written documentation in place in which the parties agree on the process for determining the value of each swap for risk management and margin purposes. Non-financial end users do not have a similar requirement, although they may request such documentation.
  - **Documentation of Any Exception to or Exemption from Mandatory Clearing and Trading.** Swap documentation must state whether an end user is relying on an exception or exemption from mandatory clearing and trading for a particular transaction.
- **Portfolio Reconciliation.** If an end user enters into swap transactions with an SD or MSP, such SD or MSP typically requests that an end user perform portfolio reconciliation on either a quarterly or annual basis (depending on the level of swap activity with the counterparty). Portfolio reconciliation is

<sup>39</sup> Available at: [http://www.cgsh.com/cftc\\_adopts\\_external\\_business\\_conduct\\_standards/](http://www.cgsh.com/cftc_adopts_external_business_conduct_standards/).



the process by which the counterparties to a swap (i) exchange the terms of all swaps between them, (ii) exchange valuations (i.e., the current market value or net present value) of each swap between them as of the close of business on the immediately preceding business day and (iii) resolve any discrepancies in material terms (including the swaps' primary economic terms) and valuations.

- **Portfolio Compression.** SDs and MSPs are required to establish written policies and procedures for portfolio compression with end users. Thus, although end users are not required to engage in portfolio compression, SDs and MSPs may ask end users to engage in compression from time to time. Portfolio compression is the process by which an SD or MSP and one or more counterparties wholly terminate or change the notional value of some, or all, of the swaps being considered in the compression process and, depending on the methodology being employed, replace the terminated swaps with other swaps whose combined notional value (or some other measure of risk) is less than the combined notional value (or some other measure of risk) of the terminated swaps being considered in the compression process.
- **Swap Confirmation.** The CFTC rules require that SDs and MSPs send post-trade acknowledgments to swap counterparties and execute post-trade confirmations for each swap transaction into which they enter (other than those cleared with a DCO or traded on a DCM or SEF). In general, end users are not responsible for confirming swap transactions, but, in order to satisfy its own obligations, an SD or MSP typically requests that an end user take certain actions, such as signing an acknowledgment of the legally binding terms of a swap transaction.
- **Request for Draft Acknowledgment.** An end user may request a pre-trade draft acknowledgment from an SD or MSP prior to entering into a swap transaction.

#### **How Does the Market Implement Such Changes in Required Documentation?**

- **ISDA's Dodd-Frank Protocols.** ISDA has completed two protocols in order to provide standardized agreements, representations and information necessary to make the parties who adhere to them compliant with Title VII.<sup>40</sup>
  - **The August 2012 ISDA DF Protocol.** The August 2012 ISDA DF Protocol is intended to help parties to swap transactions comply with certain of the requirements under Title VII, including the external business conduct standards. The framework is meant to supplement new or existing swap agreements (documented via an ISDA master agreement or a long-form confirmation) with SDs and MSPs in order to bring them into compliance with the initial set of rules finalized by the CFTC.<sup>41</sup>
  - **The March 2013 ISDA DF Protocol.** The March 2013 ISDA DF Protocol is intended to bring new or existing swap agreements into compliance with additional rules finalized by the CFTC since the August 2012 ISDA DF Protocol, including the swap trading relationship documentation, portfolio reconciliation, portfolio compression and swap confirmation rules described above.<sup>42</sup>
  - **Ongoing Process.** As the CFTC continues to finalize its rulemaking process, parties to swap transactions will need to update their documentation to remain in compliance with applicable regulations.

<sup>40</sup> Information on the Protocols may be found on ISDA's website at: <http://www2.isda.org/functional-areas/protocol-management/open-protocols/>.

<sup>41</sup> Parties may access information about August 2012 DF Protocol at: <http://www2.isda.org/functional-areas/protocol-management/protocol/8>.

<sup>42</sup> Parties may access information about March 2013 ISDA DF Protocol at: <http://www2.isda.org/functional-areas/protocol-management/protocol/12>.



- **Impact on End Users.** The CFTC rules covered by the ISDA Dodd-Frank Protocols do not directly apply to end users. Rather, Title VII imposes certain obligations on SDs and MSPs. In order to continue to deal in swaps with SDs and MSPs, end users typically need to enter into the Dodd-Frank Protocol, amend their ISDA master agreements with SDs and MSPs or otherwise enter into separate agreements or supplements to provide individualized representations and disclosures.
- **Adhering to the Dodd-Frank Protocols.** In order to take advantage of the Dodd-Frank Protocols, end users must submit an adherence letter to ISDA in which the end user agrees to certain of the terms that comprise the Dodd-Frank Protocols. Submission of the adherence letter does not, however, amend existing agreements with SD or MSP counterparties. In order to amend existing agreements, each end user must complete a questionnaire that includes representations about the legal status of the end user. The end user can choose which counterparties will receive its completed questionnaire. When an end user's questionnaire is matched to its SD or MSP counterparty, the existing swap transaction is amended to conform to those requirements of the Title VII regime covered by the Protocol.
- **Limited Flexibility of the Dodd-Frank Protocols.** The Dodd-Frank Protocols are not negotiable. If either party to a swap does not wish to enter into a protocol, then the parties must enter into a bilateral agreement to bring the swap agreements into compliance with the applicable CFTC regulations. There is, however, some flexibility built into the Dodd-Frank Protocols in that parties to each Protocol need only adopt those optional schedules applicable to their particular swap transaction. End users should consult with both their SD or MSP counterparties and counsel in order to determine the parameters of any amendments.

#### **Does Title VII Impose Additional Recordkeeping Obligations?**

- **General Recordkeeping Requirements for End Users.** CFTC rules require end users that enter into swaps to “keep full, complete, and systematic records, together with all pertinent data and memoranda” with respect to each of their swaps for a period of five years following termination of the swap. Records can be kept in either paper or electronic form, as long as the records are retrievable upon request by the CFTC within five business days.
- **Additional Recordkeeping Requirements for CFTC Registrants and Members of SEFs and DCMs.** CFTC rules require an end user that is registered with the CFTC in certain capacities (such as FCMs, but not CPOs or CTAs)<sup>43</sup> to keep communications, including oral communications and text messages, that lead to the execution of swaps and other CFTC-regulated derivatives and related cash or forward transactions. An end user that is a member of a SEF or DCM must maintain transaction records of swaps, other CFTC-regulated derivatives and related cash and forward transactions, but not oral communications or text messages.
- **CFTC Large Swap Trader Reporting.** Title VII enacted, and the CFTC implemented, certain “large swap trader reporting” requirements applicable to persons that enter into swaps linked to specified physical commodity futures contracts. While the relevant CFTC rules impose these reporting requirements on DCOs, clearing members and SDs, certain end users that own or control 50 or more gross all-months-combined futures equivalent positions in the relevant types of physical commodity swaps are required to keep records related to those swaps and must produce them upon request by the CFTC.

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<sup>43</sup> Registered CPOs and CTAs are subject to other recording requirements, which relate primarily to transaction records and investor communications.

### **Does Title VII Impose New Rules With Respect to Position Limits?**

- **In General.** Title VII allows the CFTC to set aggregate position limits on futures and options on physical commodities and economically equivalent swaps. It also narrowed the definition for bona fide hedging transactions exempted from position limits. As a result, the CFTC adopted rules that would have applied maximum aggregate position limits across 28 designated listed physical commodity futures contracts and economically equivalent swaps.
- **Position Limit Rules Invalidated.** On September 28, 2012, the District Court for the District of Columbia enjoined and vacated the new CFTC rules regarding position limits.
- **Re-Issued Position Limits Proposal.** The CFTC has re-proposed position limits rules based largely on the vacated rules in late 2013, but has not yet finalized them.<sup>44</sup> The re-proposed rules would provide end users more flexibility than the vacated rules to be able to dis-aggregate positions of affiliated companies for position limits purposes.

### **How Do Title VII's Anti-fraud and Anti-manipulation Rules Affect End Users?**

- **In General.** End users, even those making use of certain exceptions or exemptions discussed in this memorandum, are subject to the CFTC's anti-fraud and anti-manipulation provisions.
- **CFTC Title VII Rules Prohibiting Fraudulent Activity.** With respect to swaps, Title VII amended the CEA to prohibit fraudulent activity, including material misstatements and omissions in connection with futures contracts, options on futures contracts and swaps. The CFTC's rules harmonize the scope of liability for deceitful behavior and CFTC enforcement under the CEA with fraud liability and SEC enforcement under Section 10(b) of the Exchange Act.
- **CFTC Title VII Rules Prohibiting Manipulation.** Title VII amended the CEA, and the CFTC has adopted rules to provide that no person is permitted to engage in any manipulative or deceptive behavior related to any swap, commodity or futures contract or to attempt to manipulate the price of any swap, commodity or futures contract.<sup>45</sup>
- **Do the CFTC Rules Impose Additional Disclosure Obligations?** In its adopting release, the CFTC noted that its Title VII anti-fraud and anti-manipulation rules do not impose any new disclosure obligations on market participants. That said, market participants could violate the rules due to a breach of other disclosure requirements in the CEA or associated CFTC rules, or by trading on material non-public information (i) in breach of a pre-existing duty (established by law, agreement or understanding) or (ii) that was obtained through fraud or deception.
  - The application of this guidance to the non-securities derivatives markets, where market participants often trade on the basis of non-public information for hedging purposes, remains unclear.
  - A recently settled case indicates that the CFTC intends to apply its anti-fraud authority in a similar way to the SEC's application of its anti-fraud authority.<sup>46</sup>
  - End users therefore should consider where duties may arise to maintain confidentiality or not

<sup>44</sup> See 78 Fed. Reg. 75,680 (Dec. 12, 2013) ("**Position Limits Proposed Rule**") and 78 Fed. Reg. 68,946 (Nov. 15, 2013) ("**Aggregation of Positions Proposed Rule**").

<sup>45</sup> CFTC Regulations §180.1-180.2; see also 76 Fed. Reg. 41,398 (July 14, 2011) ("**Antifraud Final Rule**"). In applying the rule prohibiting price manipulation, the CFTC noted that it will use a four-part test, specifically, that: (i) the accused had the ability to influence market prices, (ii) the accused intended to create a price or price trend that does not reflect legitimate forces of supply and demand, (iii) artificial prices existed and (iv) the accused caused the artificial prices. See Antifraud Final Rule, 76 Fed. Reg. 41,398, 41,407 (July 14, 2011).

<sup>46</sup> *In the Matter of Arya Motazed*, CFTC Docket No. 16-02 (Dec. 2, 2015).

to act on potentially material information, for example in connection with business combinations and other commercial contexts, that may limit their ability to hedge in the derivatives markets.

**Does Title VII Impose Requirements on Swaps Between Non-U.S. Persons?**

- **In General.** The CFTC has issued final interpretive guidance regarding the cross-border application of its Title VII rules (the “**Cross-Border Guidance**”).<sup>47</sup> The Cross-Border Guidance defines which entities qualify as U.S. persons and are therefore generally subject to CFTC rules under Title VII. In addition, the Cross-Border Guidance defines the circumstances under which non-U.S. persons would be required to register with the CFTC as SDs or MSPs (as well as which of the rules applicable to SDs and/or MSPs would apply). As noted above, margin rules for uncleared swaps are not subject to the Cross-Border Guidance.
- **Who Is a U.S. Person?** Under the Cross-Border Guidance, whether CFTC rules apply to an end user largely depends on whether either it or its counterparty is a U.S. person. A “U.S. person” includes:
  - (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), in each case that is organized or incorporated under the laws of the United States or has its principal place of business in the United States (“**legal entity**”);
  - (iv) any pension plan for the employees, officers or principals of a legal entity described in (iii) above, unless the pension plan is primarily for foreign employees of such entity;
  - (v) a 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 prongs (i) through (v), except any such entity that is publicly offered only to non-U.S. persons and not offered to U.S. persons;
  - (vii) any legal entity (other than one in which all of its owners have limited liability) that is directly or indirectly majority-owned by one or more persons described in prongs (i) through (v) and in which such person(s) bear unlimited responsibility for the obligations and liabilities of the legal entity<sup>48</sup>; and
  - (viii) any individual account or joint account (discretionary or not) where the beneficial owner (or, in the case of a joint account, one of the beneficial owners) is a U.S. person under prongs (i) through (vii).

Under the Cross-Border Guidance, foreign branches of U.S. banks are considered “U.S. persons.”

<sup>47</sup> See 78 Fed. Reg. 45,292 (July 26, 2013).

<sup>48</sup> According to the Cross-Border Guidance, the guarantee of an entity’s swap positions does not constitute “unlimited responsibility for the obligations and liabilities of the legal entity” for this purpose.

- **Requirements Applicable to Non-U.S. End Users.**

- In general, under the Cross-Border Guidance, end users are only subject to requirements with respect to swaps where at least one counterparty is a U.S. person, unless one or both of the non-U.S. end users are guaranteed or “conduit”<sup>49</sup> affiliates of a U.S. person.
- **U.S. person end users.** Clearing, trade execution, real-time reporting, regulatory reporting and recordkeeping (the “**end-user requirements**”)<sup>50</sup> each apply with respect to swaps between a U.S. end user and any other party (including affiliates), in all cases subject to any otherwise applicable exception or exemption. External business conduct standards, and therefore adherence to both ISDA Dodd-Frank Protocols, apply to all such swaps where one party is an SD or MSP.
- **Non-U.S. person end users that are not guaranteed by or conduit affiliates of U.S. persons.**
  - **U.S. person counterparty.** The end-user requirements each apply with respect to swaps between a non-U.S. end user and a U.S. person, in all cases subject to any otherwise applicable exception or exemption. External business conduct standards and swap-dealer requirements, and therefore adherence to both ISDA Dodd-Frank Protocols, apply to all such swaps where one party is a U.S. SD or MSP.
  - **Foreign branch of U.S. bank counterparty.** The end-user requirements each apply with respect to swaps between a non-U.S. end user and a non-U.S. branch of a U.S. SD,<sup>51</sup> in all cases subject to any otherwise applicable exception or exemption. Substituted compliance with a non-U.S. regulatory regime may be available if the counterparty is a U.S. SD or MSP. External business conduct standards, and therefore adherence to the August 2012 ISDA DF Protocol, would not apply to such swaps, although swap documentation requirements, and therefore adherence to the March 2013 ISDA DF Protocol, would apply.
  - **Foreign subsidiary of a U.S. person counterparty.**
    - **SD/MSP.** Regulatory reporting applies with respect to swaps between a non-U.S. end user and a foreign subsidiary of a U.S. person if such subsidiary is an SD or MSP, although substituted compliance may apply.
    - **Non-SD/MSP.** If the foreign subsidiary of a U.S. person is not an SD or MSP, and the subsidiary is neither guaranteed by, or a conduit of, a U.S. person, then none of the end-user requirements apply, except the conditions to the inter-affiliate clearing exemption (if applicable).

<sup>49</sup> Factors that the CFTC will consider to determine whether a non-U.S. person is a “conduit” affiliate of a U.S. person include (i) whether the non-U.S. person is a majority-owned affiliate of a U.S. person, (ii) whether the non-U.S. person is controlling, controlled by or under common control with the U.S. person, (iii) whether the financial results of the non-U.S. person are consolidated in the financial statements of the U.S. person and (iv) whether the non-U.S. person, in the regular course of its business, engages in swaps with non-U.S. third parties for the purpose of hedging or mitigating risks faced by, or to take positions on behalf of, its U.S. affiliates and enters into offsetting swaps or other arrangements with its U.S. affiliates in order to transfer the risks and benefits of such swaps with third parties to its U.S. affiliates.

<sup>50</sup> This list of end-user requirements does not include margin and position limit rules, which are not yet effective. The CFTC has proposed to apply the margin rules in a broader context than other rules affecting end users (discussed above). Anti-manipulation and anti-fraud rules generally apply based on whether the relevant activity occurred within the United States or had a direct and significant connection with, or effect on, U.S. commerce.

<sup>51</sup> The CFTC has adopted guidance for whenever a swap is considered to have been entered into by a “*bona fide*” non-U.S. branch, including a requirement that the employees negotiating and agreeing to the swap on behalf of the branch not be located in a U.S. branch.

- **Other Non-U.S. Persons, including Non-U.S. Headquartered Dealers.**
  - **SD/MSP.** Regulatory reporting applies with respect to swaps between a non-U.S. end user and a non-U.S. person (other than a branch or subsidiary of a U.S. person) that is an SD or MSP, although substituted compliance may apply.
  - **Non-SD/MSP.** If the non-U.S. person is not an SD or MSP, and it is neither guaranteed by or a conduit of a U.S. person, then none of the end-user requirements apply. This includes non-U.S. affiliates of the non-U.S. end user.
- **Non-U.S. end users that are guaranteed by or a conduit affiliate of a U.S. person.**
  - A non-U.S. end user that is guaranteed by or a conduit affiliate of a U.S. person is subject to all of the end-user requirements when it enters into a swap with a U.S. or non-U.S. SD or MSP. If such end user's counterparty is either a non-U.S. SD or MSP or the non-U.S. branch of a U.S. SD, the swap documentation requirements, and therefore adherence to the March 2013 ISDA DF Protocol, apply to the swap. If such an end user's counterparty is a U.S. SD or MSP (other than the non-U.S. branch of a U.S. SD), then external business conduct standards and swap documentation requirements, and therefore adherence to both ISDA Dodd-Frank Protocols, apply to the swap.
  - Each of the end-user requirements apply with respect to swaps between two non-U.S. end users that are both guaranteed or "conduit" affiliates of U.S. persons, although substituted compliance may apply.
  - Swaps where at least one party is a "conduit" affiliate of a U.S. person are subject to public reporting and inter-affiliate clearing exemption requirements (if applicable), even if both parties are non-U.S. persons.
- Certain requirements, such as large swap trader reporting/recordkeeping and position limits, apply to all of a non-U.S. person's swaps, including swaps with non-U.S. person counterparties.

\* \* \*

Please call any of your regular contacts at the firm or any of the partners and counsel listed under [Derivatives](#) in the Practices section of our website ([www.cgsh.com](http://www.cgsh.com)) if you have any questions.

CLEARY GOTTLIEB STEEN & HAMILTON LLP

Appendix A: Summary of Title VII Requirements  
Applicable to Non-Financial End Users

| <b>Requirement</b>  | <b>Summary description</b>  | <b>Are non-financial end users generally required to comply with the requirement?</b>  |
|---|---|--|
| <i>Registration as SD/MSP</i>   | Certain parties must register with the CFTC, triggering a host of regulations           | No, if activity does not exceed relevant thresholds  |
| <i>Mandatory Clearing</i>   | Certain designated derivatives must be cleared through a DCO                            | No, if swap is for hedging or mitigating commercial risk by non-financial end users, or another exclusion or exception applies |
| <i>Mandatory Trade Execution</i>  | Certain designated derivatives must be traded on a DCM or SEF                           | No, if swap is for hedging or mitigating commercial risk by non-financial end users, or another exclusion or exception applies |
| <i>ECP Trading Requirement</i>  | In general, only ECPs can enter into OTC swaps or guarantee such swaps                  | Yes  |
| <i>Margin for Uncleared Swaps</i>   | Financial counterparties will generally need to exchange margin with SDs and MSPs       | No, for non-financial end users  |
| <i>Real-Time Public Reporting</i>   | The reporting party must make report trade information in real-time to SDRs or the CFTC | Yes, although SD and MSP counterparties generally are responsible  |
| <i>Regulatory Reporting</i>   | The reporting party must make report trade information in real-time to SDRs or the CFTC | Yes, although SD and MSP counterparties generally are responsible  |
| <i>Recordkeeping</i>  | Counterparties must retain records and documents related to trades                      | Yes, with enhanced requirements for end users that are members of a SEF or DCM   |
| <i>External Business Conduct, Swap Documentation, Confirmation and Portfolio Reconciliation and Compression</i> | Trades must be documented pursuant to CFTC rules  | Requirements apply to end users indirectly when trading with SDs and MSPs  |
| <i>Position Limits</i>  | CFTC's rule regarding position limits has been vacated and re-proposed                  | Yes, once the rules are finalized  |
| <i>Anti-fraud and anti-manipulation</i>   | CFTC rules prohibit fraud and manipulation involving swaps                              | Yes  |

Appendix B: Summary of Title VII Requirements  
Applicable to Non-U.S. Person End Users

**End User**

|  | U.S. person   | Non-U.S. person*   |
|--|---|--|
| U.S. SD/MSP  | <ul style="list-style-type: none"> <li>• Clearing &amp; trade execution</li> <li>• Margin</li> <li>• Public reporting</li> <li>• SDR reporting</li> <li>• Large trader reporting</li> <li>• Recordkeeping</li> <li>• Adherence to both ISDA DF protocols</li> </ul> | <ul style="list-style-type: none"> <li>• Clearing &amp; trade execution</li> <li>• Margin</li> <li>• Public reporting</li> <li>• SDR reporting</li> <li>• Large trader reporting</li> <li>• Recordkeeping</li> <li>• Adherence to both ISDA DF protocols</li> </ul>  |
| U.S. non-SD/MSP  | <ul style="list-style-type: none"> <li>• Clearing &amp; trade execution</li> <li>• Public reporting</li> <li>• SDR reporting</li> <li>• Large trader reporting</li> <li>• Recordkeeping</li> </ul>  | <ul style="list-style-type: none"> <li>• Clearing &amp; trade execution</li> <li>• Public reporting</li> <li>• SDR reporting</li> <li>• Large trader reporting</li> <li>• Recordkeeping</li> </ul>   |
| Non-U.S. branch of U.S. SD/MSP bank  | <ul style="list-style-type: none"> <li>• Clearing &amp; trade execution</li> <li>• Margin</li> <li>• Public reporting</li> <li>• SDR reporting</li> <li>• Large trader reporting</li> <li>• Recordkeeping</li> <li>• Adherence to both ISDA DF protocols</li> </ul> | <ul style="list-style-type: none"> <li>• Clearing &amp; trade execution (substituted compliance)</li> <li>• Margin (limited substituted compliance)</li> <li>• Public reporting (substituted compliance)</li> <li>• SDR reporting</li> <li>• Large trader reporting</li> <li>• Recordkeeping (substituted compliance)</li> <li>• Adherence to March 2013 ISDA DF Protocol</li> </ul> |
| Non-U.S. SD/MSP that is a subsidiary of a U.S. person but is not guaranteed by a U.S. person | <ul style="list-style-type: none"> <li>• Clearing &amp; trade execution</li> <li>• Margin</li> <li>• Public reporting</li> <li>• SDR reporting</li> <li>• Large trader reporting</li> <li>• Recordkeeping</li> <li>• Adherence to both ISDA DF protocols</li> </ul> | <ul style="list-style-type: none"> <li>• Margin (substituted compliance)</li> <li>• SDR reporting (substituted compliance)</li> <li>• Large trader reporting</li> </ul>  |

Counterparty



**End User**

|   | U.S. person   | Non-U.S. person*  |
|---|---|---|
| Non-U.S. SD/MSP that is a subsidiary of a U.S. person and that is guaranteed by a U.S. person           | <ul style="list-style-type: none"> <li>• Clearing &amp; trade execution</li> <li>• Margin</li> <li>• Public reporting</li> <li>• SDR reporting</li> <li>• Large trader reporting</li> <li>• Recordkeeping</li> <li>• Adherence to both ISDA DF protocols</li> </ul> | <ul style="list-style-type: none"> <li>• Margin (limited substituted compliance)</li> <li>• SDR reporting (substituted compliance)</li> <li>• Large trader reporting</li> <li>• Adherence to March 2013 ISDA DF Protocol</li> </ul> |
| Non-U.S. Non-SD/MSP that is a subsidiary of a U.S. person, but is not guaranteed or a conduit affiliate | <ul style="list-style-type: none"> <li>• Clearing &amp; trade execution</li> <li>• Public reporting</li> <li>• SDR reporting</li> <li>• Large trader reporting</li> <li>• Recordkeeping</li> </ul>  | No requirements apply**   |
| Non-U.S. Non-SD/MSP that is a subsidiary of a U.S. person and that is guaranteed by a U.S. person       | <ul style="list-style-type: none"> <li>• Clearing &amp; trade execution</li> <li>• Public reporting</li> <li>• SDR reporting</li> <li>• Large trader reporting</li> <li>• Recordkeeping</li> </ul>  | <ul style="list-style-type: none"> <li>• Large trader reporting</li> </ul>  |
| Non-U.S. Non-SD/MSP that is a subsidiary of a U.S. person and that is a conduit affiliate               | <ul style="list-style-type: none"> <li>• Clearing &amp; trade execution</li> <li>• Public reporting</li> <li>• SDR reporting</li> <li>• Large trader reporting</li> <li>• Recordkeeping</li> </ul>  | <ul style="list-style-type: none"> <li>• Conditions to inter-affiliate clearing exemption</li> </ul>  |
| Other Non-U.S. SD/MSP (and not branch or subsidiary of a U.S. person)                                   | <ul style="list-style-type: none"> <li>• Clearing &amp; trade execution</li> <li>• Margin</li> <li>• Public reporting</li> <li>• SDR reporting</li> <li>• Large trader reporting</li> <li>• Recordkeeping</li> <li>• Adherence to both ISDA DF protocols</li> </ul> | <ul style="list-style-type: none"> <li>• SDR reporting (substituted compliance)</li> <li>• Large trader reporting</li> </ul>  |
| Other Non-US non-SD/MSP   | <ul style="list-style-type: none"> <li>• Clearing &amp; trade execution</li> <li>• Public reporting</li> <li>• SDR reporting</li> <li>• Large trader reporting</li> <li>• Recordkeeping</li> </ul>  | No requirements apply**   |

Counterparty

\* If the non-U.S. end user is guaranteed by or a conduit affiliate of a U.S. person, please see above to determine if additional requirements apply.

\*\* Anti-manipulation, anti-fraud and position limits requirements may apply.

Appendix C: Key CFTC Rulemakings Affecting End Users

- In General
  - *Product Definitions Final Rule*, 77 Fed. Reg. 48,208 (August 13, 2012)
  - *Final Treasury Determination*, 77 Fed. Reg. 69,694 (Nov. 20, 2012)
  - *Registered Swap Entity Final Rule*, 77 Fed. Reg. 30,596 (May 23, 2012)
- Clearing
  - *Clearing Requirement Determination*, 77 Fed. Reg. 74,284 (Dec. 13, 2012)
  - *End-User Exception Final Rule*, 77 Fed. Reg. 42,560 (July 19, 2012)
  - *Inter-Affiliate Exemption Final Rule*, 78 Fed. Reg. 21,750 (Apr. 11, 2013)
- Trade Execution
  - *SEF Final Rule*, 78 Fed. Reg. 33,476 (Jun. 4, 2013)
  - *Available to Trade Final Rule*, 78 Fed. Reg. 33,606 (Jun. 4, 2013).
- Margin
  - *Prudential Regulators Margin and Capital Final Rule*, 80 Fed. Reg. 74,840 (Nov. 30, 2015)
  - *CFTC Final Margin Rule*, 81 Fed. Reg. 636 (Jan. 6, 2016)
- Reporting
  - *Real-Time Public Reporting Final Rule*, 77 Fed. Reg. 1182, 1243 (Jan. 9, 2012)
  - *Regulatory Reporting and Recordkeeping Final Rule*, 77 Fed. Reg. 2136 (Jan. 13, 2012)
  - *Reporting of Unexpired Pre-Enactment Swaps Final Rule*, 77 Fed. Reg. 35,200 (June 12, 2012)
  - *Block Trade Final Rule*, 78 Fed. Reg. 32,866 (May 31, 2013)
- Documentation & Business Conduct
  - *Swap Documentation Final Rule*, 77 Fed. Reg. 55,904, (Sept. 11, 2012)
  - *External Business Conduct Standards Final Rule*, 77 Fed. Reg. 9734 (Feb. 17, 2012)
  - *Internal Business Conduct Standards Final Rule*, 77 Fed. Reg. 20,128 (Apr. 3, 2012)
- Recordkeeping
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  - *Records of Commodity Interests Rule*, 80 Fed. Reg. 80,247 (Dec. 24, 2015).
- Anti-fraud and Anti-manipulation
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- Position Limits
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- Cross-Border Application
  - *Cross-Border Guidance*, 78 Fed. Reg. 45,292 (July 26, 2013)

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