

January 7, 2014

UPDATED: CFTC's December 2013 Substituted Compliance Determinations and No-Action Relief

Key Takeaways:

- > The CFTC is permitting non-U.S. SD/MSPs whose swap activities might subject them to certain CFTC regulations, to comply with certain regulations in their home jurisdiction(s) instead of complying with the relevant CFTC regulations.
- > "Entity-level" substituted compliance is being permitted in Australia, Canada, the European Union, Hong Kong, Japan, and Switzerland for a broad range of entity-level requirements.
- > "Transaction-level" substituted compliance is also available in the European Union for certain requirements, but not for clearing and related swap processing, or real-time public reporting.
- > "Transaction-level" substituted compliance is also available in Japan, but on a more limited basis than in the European Union.
- > Time limited no-action relief has also been granted to non-U.S. SD/MSPs established under the laws of Australia, Canada, the European Union, Japan or Switzerland from the CFTC's SDR Reporting Rules and Historical Swap Data Reporting Rules.

Introduction

Concurrently with the Commodity Futures Trading Commission's (the "**CFTC**") release of its extraterritorial guidance on the application of its swap regulations¹ (the "**ET Guidance**") the CFTC also released a time-limited exemptive order² (the

¹ Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 FR 45292 (July 26, 2013), *available at* <http://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/Cross-BorderApplicationofSwapsProvisions/ssLINK/2013-17958a>; *see also* Linklaters LLP, CFTC Issues Final Extraterritoriality Guidance Respecting Title VII of the Dodd-Frank Act and Provides Time-Limited Exemptive Relief to Certain Non-U.S. Market Participants (the "**Linklaters ET Guidance Note**"), *available at* http://www.linklaters.com/pdfs/mkt/newyork/A16858592_CFTC%20ET%20Guidance.pdf.

² Exemptive Order Regarding Compliance With Certain Swap Regulations, 78 FR 43785 (July 22, 2013), *available at* <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-17467a.pdf>; *see also* Linklaters ET Guidance Note.

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“**Exemptive Order**”) which generally allowed most non-U.S. swap dealers (“**SDs**”) and major swap participants (“**MSPs**”, collectively “**SD/MSPs**”) to comply with the laws of their local jurisdiction. This effectively provided a stop-gap to minimize market disruptions as foreign entities determined the impact of the ET Guidance on their current swap activities. It also provided the CFTC time to review the rules and regulations of various foreign jurisdictions so that it could determine the extent to which substituted compliance could initially be permitted, since many foreign jurisdictions are still in the early phases of proposing and finalizing various parts of their respective swap regulations.

Prior to the expiration of the CFTC’s Exemptive Order, which was set to lapse on December 21, 2013, the CFTC released a series of eight comparability determinations and no-action letters addressing various regulatory compliance obligations for SD/MSPs that will allow eligible SD/MSPs to comply with the laws of their local jurisdictions instead of certain CFTC regulations. Six entity-level comparability determinations were issued with respect to Australia, Canada, the European Union (“**EU**”), Hong Kong, Japan, and Switzerland.³ Two transaction-level comparability determinations were made with respect to certain requirements in the EU⁴ and Japan.⁵

The comparability determinations do not generally allow an entity subject to the CFTC’s and another jurisdiction’s regulations to comply with the non-CFTC jurisdiction’s swap regulations and forgo compliance with all of the CFTC’s swap regulations. As evidenced by the first of the CFTC’s comparability determinations, only portions of a local jurisdiction’s laws may be determined to be comparable by the CFTC. In such instances, substituted compliance will only be partially available in respect to that local jurisdiction’s laws. Consequently, entities wishing to utilize substituted compliance will need to carefully consider the following:

- > if such entity is permitted to utilize substituted compliance; and
- > what regulations have been covered by a comparability determination.

The effective date for the comparability determinations was December 27, 2013.

Foreign Entities Permitted to Utilize Substituted Compliance

The CFTC’s ET Guidance noted instances where substituted compliance would be available to certain market participants. A swap market participant’s ability to

³ See CFTC Press Release 6802-13, available at <http://www.cftc.gov/PressRoom/PressReleases/pr6802-13>. For the individual determinations for respective jurisdictions see the CFTC’s website, available at <http://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/index.htm>.

⁴ Comparability Determination for the European Union: Certain Transaction-Level Requirements, 78 FR 78878 (Dec. 27, 2013), available at <http://www.cftc.gov/ucm/groups/public/@Ifederalregister/documents/file/2013-30981a.pdf>.

⁵ Comparability Determination for Japan: Certain Transaction-Level Requirements, 78 FR 78890 (Dec. 27, 2013), available at <http://www.cftc.gov/ucm/groups/public/@Ifederalregister/documents/file/2013-30977a.pdf> (the scope of the comparability determination with respect to Japan was more limited)

elect to utilize substituted compliance depends on its status (e.g. non-U.S. person, Guaranteed/Conduit Affiliate, Foreign branch, etc.) and, in respect of particular swap transactions, its counterparty's status.

The below charts summarize the various counterparty fact patterns where substituted compliance may potentially be elected by an SD/MSP. However, whether substituted compliance is actually available in any particular situation will depend on the scope of regulations, if any, covered by an affirmative comparability determination (absent such determination or no-action relief, substituted compliance will not generally be permissible).

Entity-Level Requirements – Is substituted compliance available for transactions between the following counterparties?				
	<i>U.S. person</i>	<i>Foreign branch of a U.S. bank that is an SD/MSP</i>	<i>Guaranteed or Conduit Affiliate</i>	<i>Non-U.S. person that is not a Guaranteed or Conduit Affiliate</i>
<i>U.S. SD or MSP⁶</i>	No	No	No	No
<i>Foreign branch of a U.S. bank that is an SD/MSP</i>	No	No	No	No
<i>Non-U.S. SD or MSP</i>	Yes, limited ⁷	Yes, limited ⁸	Yes, limited ⁹	Yes, limited ¹⁰

⁶ According to a summary appendix to the ET Guidance, where a U.S. SD/MSP solicits or negotiates a swap through a foreign affiliate but books the swap in the U.S. entity, the Category B requirements would not apply unless its counterparty was a U.S. person (other than a foreign branch of a U.S. bank that is an SD/MSP). ET Guidance at 45369. However, this carve out is not discussed in the text of the ET Guidance at all.

⁷ If covered in a comparability determination, substituted compliance is available for "**Category 1 Entity-Level Requirements**," which includes capital adequacy, Chief Compliance Officer, risk management, and swap data recordkeeping (except CFTC regulations 23.201(b)(3) and (4)). Substituted compliance is not available for "**Category 2 Entity-Level Requirements**," which include SDR Reporting Requirements, certain aspects of swap data recordkeeping relating to complaints and marketing and sales materials (CFTC Regulations 23.201(b)(3) and (4)), and Large Trader Reporting.

⁸ *Id.*

⁹ Substituted Compliance is available for Category 1 Entity-Level Requirements and the SDR Reporting Requirements, provided such requirements are covered by a comparability determination.

¹⁰ Provided the applicable requirements are covered by a comparability determination, substituted compliance is available for Category 1 and Category 2 Entity-Level Requirements, except that the non-U.S. SD would still be required to report pursuant to the Large Trader Reporting Requirements.

Entity-Level Requirements – Is substituted compliance available for transactions between the following counterparties?				
	<i>U.S. person</i>	<i>Foreign branch of a U.S. bank that is an SD/MSP</i>	<i>Guaranteed or Conduit Affiliate</i>	<i>Non-U.S. person that is not a Guaranteed or Conduit Affiliate</i>
<i>Guaranteed or Conduit Affiliate</i>	No	No	Yes ¹¹	N/A ¹²

As reflected above, substituted compliance with respect to the entity-level requirements is limited to non-U.S. SD/MSPs and transactions between Guaranteed Affiliates and/or Conduit Affiliates.

With respect to the transaction-level requirements, the CFTC was more willing to permit substituted compliance, as summarized in the table below:

Transaction-Level Requirements – Is substituted compliance available for transactions between the following counterparties? ¹³				
	<i>U.S. person</i>	<i>Foreign branch of a U.S. bank that is an SD/MSP</i>	<i>Guaranteed or Conduit Affiliate</i>	<i>Non-U.S. person that is not a Guaranteed or Conduit Affiliate</i>
<i>U.S. SD or MSP</i>	No	No	No	No
<i>Foreign branch of a U.S. bank that is an SD/MSP</i>	No	Yes	Yes	Yes, but not for external business conduct requirements ¹⁴

¹¹ The “Entity-Level Requirements” as such term is defined in the ET Guidance do not apply to non-SD/MSPs, however certain CFTC Category 2 Entity-Level Requirements do apply in transactions between Guaranteed Affiliates and/or Conduit Affiliates, and substituted compliance is permitted if such requirements are covered by an affirmative comparability determination.

¹² Large Trader Reporting Requirements will apply to a party to the transaction if such party is a clearing member.

¹³ As discussed earlier, ability for an entity to actually utilize substituted compliance is subject to there also being an affirmative comparability determination with respect to the applicable regulations.

¹⁴ The ET Guidance provides that, with respect to a swap between a foreign branch of a U.S. SD/MSP and a non-U.S. person that is not a Guaranteed or Conduit Affiliate, and which takes place in a country other than Australia, Canada, the EU, Hong Kong, Japan or Switzerland (the “**Substituted Compliance Applicant Jurisdictions**”), the foreign branch may comply with local

Transaction-Level Requirements – Is substituted compliance available for transactions between the following counterparties? ¹³				
	<i>U.S. person</i>	<i>Foreign branch of a U.S. bank that is an SD/MSP</i>	<i>Guaranteed or Conduit Affiliate</i>	<i>Non-U.S. person that is not a Guaranteed or Conduit Affiliate</i>
<i>Non-U.S. SD or MSP not using U.S. personnel</i>	No, but compliance with “essentially identical” non-U.S. rules allowed ¹⁵	Yes	Yes ¹⁶	N/A ¹⁷
<i>Guaranteed or Conduit Affiliate</i>	No	No	Yes ¹⁸	N/A

“Not using U.S. personnel” alludes to the impact conducting certain swap activities in the U.S. may have on a non-U.S. SD/MSP’s compliance obligations. If a swap is with a U.S. branch of a non-U.S. SD/MSP, substituted compliance is

rules even absent a CFTC comparability determination regarding that jurisdiction provided that (1) the aggregate notional value of all of the swaps of the U.S. SD/MSP’s foreign branches outside of the Substituted Compliance Applicant Jurisdictions does not exceed five percent of its total notional amount of swaps and (2) the U.S. SD/MSP maintains records to verify that the first element is true. ET Guidance at 45351.

¹⁵ While substituted compliance is not available for swaps between Non-U.S. SD/MSPs and U.S. persons, the CFTC indicated that “a market participant would be deemed in compliance with the relevant Dodd-Frank requirements where it complies with requirements in its home jurisdiction that are essentially identical to the Dodd-Frank requirements.” ET Guidance at 232. In this regard, the CFTC staff issued a no-action letter finding that certain CFTC and European Union risk mitigation rules are “essentially identical.” Accordingly, a transaction subject to both EMIR and the CFTC’s swap regulations may comply with EMIR’s risk mitigation requirements in lieu of the CFTC’s risk mitigation requirements, provided certain requirements are met. For more details, see Linklaters LLP, CFTC Provides No-Action Relief for Market Participants Complying with Certain Essentially Identical EMIR Risk Mitigation Rules, *available at* <http://linklaters.com/pdfs/mkt/newyork/A17143975.pdf>.

¹⁶ The ET Guidance provides that a Conduit Affiliate may achieve compliance with the Category A requirements by complying with the conditions of the CFTC’s rule providing for an exception from clearing for inter-affiliate trades (the “**Inter-Affiliate Exception**”). These conditions are discussed in our client note on the Inter-Affiliate Exception, which is *available at* <http://linklaters.com/pdfs/mkt/newyork/A16413038.pdf>.

¹⁷ The transaction-level requirements would not apply to this transaction by their terms, thus substituted compliance is not an issue.

¹⁸ The “Transaction-Level Requirements” as defined in the ET Guidance do not apply to non-SD/MSPs, however certain CFTC Category A Transaction-Level Requirements do apply in transactions between Guaranteed Affiliates and/or Conduit Affiliates, and substituted compliance is permitted in such cases if such requirements are covered by an affirmative comparability determination.

not permitted and the transaction must comply with all of the CFTC's transaction-level requirements.¹⁹ Additionally, if a non-U.S. SD enters into a swap transaction with a non-U.S. person, and such swap is "arranged, negotiated or executed by personnel or agents of the non-U.S. SD located in the United States" then such transaction is also not eligible for substituted compliance with the CFTC's transaction-level requirements.²⁰ This would even apply where the swap is ultimately booked in a non-U.S. branch or affiliate of such non-U.S. SD.²¹ However, as discussed below, the CFTC has provided no-action relief from certain transaction-level requirements when non-U.S. SDs enter into swap transactions and such swap is arranged, negotiated or executed by personnel or agents of such non-U.S. SDs located in the United States.

Consistent with the treatment of the entity-level requirements, although a transaction between two parties may be of a type or category that is theoretically eligible for substituted compliance, substituted compliance is only available to the extent the applicable local jurisdiction's laws are included in an affirmative comparability determination. For this reason, it is necessary to understand the detail of the comparability determinations summarized below to determine the availability of substituted compliance with respect to any particular swap transaction.

The CFTC identified limits to electing substituted compliance. An SD/MSP that is not required to comply with the foreign laws and regulations upon which the CFTC based its comparability determination may not voluntarily elect to comply therewith in order to be able to rely on substituted compliance. Thus, only an SD/MSP that is legally required to comply with a law or regulation determined to be comparable may utilize substituted compliance.

In this context, the CFTC also noted that the concept of MSP "is not explicitly mirrored in the EU legislation" so the CFTC could not confirm that an MSP would always be covered by the comparable EU laws and regulations upon which the CFTC based its comparability determination.²² However, the European Commission and European Securities and Markets Authority stated to the CFTC that the definition of an "investment firm" under MiFID is considerably wider than that of an SD, and thus MSP's should, in most cases, be caught by the definition of "investment firm."²³

¹⁹ ET Guidance at 45350 (footnote 513).

²⁰ CFTC Staff Advisory No. 13-69 (Nov. 14, 2013), *available at* <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/13-69.pdf>.

²¹ *Id.*

²² Comparability Determination for the European Union: Certain Transaction-Level Requirements, 78 FR at 78881 (footnote 22).

²³ *Id.* The CFTC also noted that "[c]urrently, there are no MSPs organized outside the U.S." and cautioned any non-financial entity organized outside the U.S. and applying for registration as an MSP to consider carefully whether the laws and regulations determined to be comparable by the CFTC are applicable to such entity. *Id.* at 78882 (footnote 32).

Entity-Level Requirements

The CFTC determined certain portions of six jurisdictions' laws and regulations were sufficient for an affirmative finding of comparability with respect to an SD/MSP's regulatory obligations regarding (i) chief compliance officer; (ii) risk management; and (iii) swap data recordkeeping (collectively, the "**Internal Business Conduct Requirements**").²⁴ The six jurisdictions were:

- > Australia,
- > Canada,
- > the EU,
- > Hong Kong,
- > Japan, and
- > Switzerland

The CFTC published a helpful summary chart of its entity-level comparability determinations, reproduced and attached at the end of this Client Note as Appendix 1 (the "**Summary Chart**").

The Summary Chart also highlights in Notes 1 through 4 therein that although the CFTC may have issued a comparability determination for a particular CFTC regulation, such determination may not encompass the entire regulation. For example, although the CFTC affirmed the comparability of CFTC regulation § 3.3 (Chief Compliance Officer), the CFTC excepted §§ 3.3(e) (Annual report)²⁵ and (f) (Furnishing the annual report to the CFTC) from such comparability determinations for various jurisdictions. However, the CFTC noted where any SD/MSP is subject to § 3.3 and the local comparable regulations also apply, the SD/MSP may comply with the provisions of such local regulation and be deemed compliant with §§ 3.3(e) and (f) (as applicable), provided the SD/MSP certifies and furnishes to the CFTC the appropriate annual compliance report, in accordance with §§ 3.3(e) and/or (f), diligencing compliance with the applicable jurisdiction's regulations.

It should also be noted that although the CFTC refers to the comparability determination with reference to the "Entity-Level Requirements," the reference does not encompass all of the "Entity-Level Requirements" as such term was defined in the Exemptive Order.²⁶ Instead, the comparability determinations are

²⁴ For a summary of the comparability determinations for the Entity-Level Requirements see the CFTC's "Summary Of Entity-Level Comparability Determinations," available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/cptable122013.pdf>.

²⁵ CFTC regulation § 3.3(e) was only excepted from the comparability determination with respect to Australia. For the other five jurisdictions, local regulations were deemed comparable to § 3.3(e).

²⁶ The Entity-Level Requirements under the Exemptive Order consist of 17 CFR 1.31 (Books and records), 3.3 (Chief Compliance Officer), 23.201 (Required records), 23.203 (Records; retention and inspection), 23.600 (Risk Management Program for SD/MSPs), 23.601 (Monitoring of position limits), 23.602 (Diligent supervision), 23.603 (Business continuity and disaster recovery), 23.605 (Conflicts of interest policies and procedures), 23.606 (General information; available for disclosure

only with respect to a limited number of the Exemptive Order's "Entity-Level Requirements" identified in each respective comparability determination. Noticeably missing from the CFTC's comparability determinations of regulations which were part of the Exemptive Order's Entity-Level Requirements were the Part 45 and Part 46 reporting requirements (the "**SDR Reporting Requirements**"). However, the CFTC did note that it may provide a comparability determination with respect to the SDR Reporting requirements in a separate notice. Additionally, as discussed in more detail below, the CFTC also provided no-action relief with respect to the SDR Reporting Requirements while it considers such comparability, which will be a reprieve to non-U.S. SD/MSPs.

Transaction-Level Requirements – EU Comparability

In addition to the comparability determination for certain entity-level requirements, the CFTC also issued a comparability determination with respect to the laws and regulations applicable in the EU regarding certain transaction-level requirements, including (i) swap trading relationship documentation, (ii) swap portfolio reconciliation and compression, (iii) trade confirmation and (iv) daily trading records²⁷ (the "**EU-TL Determination**").²⁸ Many of the regulations identified as comparable were already covered by the CFTC no-action relief provided in CFTC Letter 13-45 which found certain EMIR risk mitigation rules to be "essentially identical" to the CFTC's risk mitigation rules.²⁹ Accordingly, the impact of the EU-TL Determination on the market will be limited. The parties that may benefit from the EU-TL Determination are non-U.S. SD/MSPs that are counterparty to a foreign branch of a U.S. SD/MSP bank, Guaranteed Affiliate or Conduit Affiliate.³⁰ In such transactions, the non-U.S. SD/MSP will now be able to rely on the EU-TL Determination for substituted compliance and also comply with applicable EU laws and regulations and be deemed in compliance with (i) the daily trading record requirements at CFTC Regulation 23.202 (Daily trading records) (excepting § 23.202(a)(1) (Pre-execution trade information) and (b)(1) (Daily records of certain oral and written communications)) and (ii) all of CFTC

and inspection), 23.608 (Restrictions on counterparty clearing relationships), 23.609 (Clearing member risk management), and parts 45 (Swap data recordkeeping and reporting requirements) and 46 (Swap data recordkeeping and reporting requirements: Pre-enactment and Transaction Swaps) of the CFTC's regulations.

²⁷ Such requirements are codified in CFTC Regulations at 17 CFR 23.202 (Daily trading records) (excepting § 23.202(a)(1) (Pre-execution trade information) and (b)(1) (Daily records of certain oral and written communications)), 23.501 (Swap confirmation), 23.502 (Portfolio reconciliation), 23.503 (Portfolio compression), 23.504(b)(2), and 23.504(b)(4) (Swap trading relationship documentation).

²⁸ *Supra* fn. 4.

²⁹ See Linklaters LLP, CFTC Provides No-Action Relief for Market Participants Complying with Certain Essentially Identical EMIR Risk Mitigation Rules, *available at* <http://linklaters.com/pdfs/mkt/newyork/A17143975.pdf>.

³⁰ For the purposes of this Client Note, the terms "Guaranteed Affiliate" and "Conduit Affiliate" have the respective meanings used in the ET Guidance; see also Linklaters ET Guidance Note.

Regulation 23.502 (Portfolio reconciliation).³¹ This was not possible under the prior relief provided in the CFTC Letter 13-45.

In general, market participants executing swap transactions covered by the transaction-level substituted compliance determination will likely see no noticeable changes in their swap transactions, provided such transactions are already compliant with existing CFTC regulations³² and applicable EMIR regulations.³³ However, non-U.S. SD/MSPs and foreign branches of U.S. SD/MSP banks may adjust internal compliance policies and procedures based on the EU-TL Determination.³⁴

Transaction-Level Requirements – Japan Comparability

The CFTC also issued a comparability determination with respect to certain Japanese laws and regulations, although covering far fewer transaction-level requirements (the “**Japan-TL Determination**”).³⁵ Specifically, the Japan-TL Determination only covered the (i) daily trading records and (ii) swap trading confirmation and valuation documentation requirements of CFTC Regulations 23.202 and 23.504,³⁶ respectively. Similar to the EU-TL Determination, because not all of the swap documentation requirements are covered in the Japan-TL Determination, swap transactions subject to both the CFTC’s documentation requirements and Japanese law, will still require that the counterparties adhere to the ISDA March 2013 DF Protocol and exchange questionnaires, or that other documentation having the same effect be in place between the counterparties.

SDR Reporting Requirements – No-Action Relief

Concurrently with the release of the CFTC’s comparability determinations, the CFTC also released No-Action Letter 13-75 (the “**13-75 Letter**”), which provides relief from the SDR Reporting Requirements for certain transactions between certain market participants.³⁷ Specifically, relief under the 13-75 Letter is available

³¹ Prior to the EU-TL Determination, the applicable CFTC no-action relief only found part of CFTC Regulation 23.502 as “essentially identical” to applicable EU laws and regulations.

³² This may have been achieved by adherence to the ISDA March 2013 DF Protocol or other documentation having the same effect.

³³ This may have been achieved by either (i) adherence to the ISDA 2013 EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol or (ii) bi-lateral agreement between parties to the DFP2 to EMIR Top Up Agreement.

³⁴ For example, a non-U.S. SD/MSP in the EU may set up internal processes regarding portfolio reconciliation to default entirely to EMIR. Prior to the EU-TL Determination, this internal set-up presented regulatory risk, since such entity was still required to comply with parts of the CFTC’s regulations regarding portfolio reconciliation.

³⁵ *Supra* fn. 5.

³⁶ For CFTC Regulation 23.504 (Swap trading relationship documentation), comparability was only determined in the affirmative for CFTC Regulations 23.504(a)(2), (b)(1), (2), (3) and (4), (c), and (d). The determination did not extend to CFTC Regulations 23.504(b)(5) and (6), which require that swap documentation include notice of the status of the counterparty under the orderly liquidation procedures of Title II of the Dodd-Frank Act, and the effects of clearing on bilaterally executed swaps, respectively.

³⁷ CFTC No-Action Letter No. 13-75 (Dec. 20, 2013), *available at* <http://www.cftc.gov/ucm/groups/public/@llettergeneral/documents/letter/13-75.pdf>.

to non-U.S. SD/MSPs established under the laws of one of the following five jurisdictions:

- > Australia;
- > Canada;
- > the EU;
- > Japan; or
- > Switzerland.³⁸

Additionally, entities relying on the 13-75 Letter relief may not be part of an affiliated group in which the ultimate parent entity is a U.S. SD/MSP, U.S. bank, U.S. financial holding company or U.S. bank holding company (an entity eligible for relief under the 13-75 letter, a “**Covered Non-U.S. SD/MSP**”). Additionally, the no-action relief is only available for a limited time and is only applicable when the Covered Non-U.S. SD/MSP’s counterparty is a non-U.S. person (whether or not a Guaranteed Affiliate or Conduit Affiliate).

The no-action relief for Covered Non-U.S. SD/MSPs’ transactions with non-U.S. persons that are **not** Guaranteed Affiliates or Conduit Affiliates will expire on the earlier of: (a) 30 days following the issuance of a comparability determination by the CFTC for the jurisdiction in which the Covered Non-U.S. SD/MSP is established; and (b) December 1, 2014.

For transactions where the non-U.S. person counterparty **is** a Guaranteed Affiliate or Conduit Affiliate, the no-action relief with respect to the Part 45 SDR Reporting Rules will expire on March 3, 2014. The no-action relief with respect to the Part 46 Historical Swap Data Reporting Rules will expire on April 2, 2014.

The reporting obligations of a swap execution facility (“**SEF**”) or designated contract market (“**DCM**”) under the Part 45 reporting requirements are not affected by the 13-75 Letter. Thus, a swap executed by a non-U.S. SD on a SEF or DCM would still be reported to a swap data repository by such SEF or DCM.

Part 45 and Part 46 Recordkeeping Requirements

The 13-75 Letter’s no-action relief only applies to the Part 45 and Part 46 reporting requirements. The relief does not extend to the recordkeeping requirements thereunder.³⁹ However, during the relief period, the CFTC did provide no-action relief in instances where a non-U.S. SD/MSP fails to maintain records identifying a non-U.S. counterparty to a swap by means of a legal entity identifier (“**LEI**”) provided that:

- > the counterparty’s LEI is not publicly available;

³⁸ Noticeably missing from this list is Hong Kong. The CFTC did not explain the exclusion of Hong Kong in the relief.

³⁹ See CFTC Regulations 45.2 (Swap recordkeeping), 45.6 (Legal entity identifiers), 46.2 (Recordkeeping for pre-enactment and transaction swaps) and 46.4 (Unique identifiers).

- > the counterparty has not already provided its LEI to the non-U.S. SD/MSP; and
- > the counterparty does not provide its LEI to the non-U.S. SD/MSP in connection with the swap transaction, provided that the non-U.S. SD/MSP generates a substitute counterparty identifier for such counterparty and utilizes such identifier in the records that the non-U.S. SD/MSP is required to maintain as a condition of relying on such relief.

Clearing, Real-Time Reporting and Margin Requirements

The CFTC declined to determine whether comparability exists with respect to the EU's and Japan's (1) clearing and swap processing and (2) real-time public reporting requirements.⁴⁰ In reaching this decision, the CFTC took the view that there are no comparable applicable laws or regulations in the EU or Japan. Providing some hint as to whether this view will change once applicable law and regulations in the EU or Japan are further finalized and definitive, the CFTC indicated that it may address requests for comparability in a separate notice at a later date.

However, with respect to Japan, the CFTC did note that certain no-action relief from the CFTC's clearing requirement was provided to certain participants of the Japan Securities Clearing Corporation ("**JSCC**").⁴¹ As JSCC is currently the only licensed clearing organization under the Financial Instruments and Exchange Act, No. 25 of 1948 ("**FIEA**") in Japan, applicable participants, including Japanese SDs, may continue clearing yen-denominated interest rate swaps at JSCC instead of at a CFTC-registered derivatives clearing organization ("**DCO**"). However, JSCC is currently in the process of registering as a DCO, and upon such registration, a Japanese SD could comply with both the CFTC's clearing requirements and the FIEA clearing requirements by clearing relevant swaps at JSCC.

The CFTC also noted that it did not address the capital adequacy and margin requirements in the entity-level comparability determinations. Such determination cannot be made at this time because the CFTC has not finalized its own regulations regarding margin and capital adequacy. The CFTC did not indicate when it anticipates such rules may be finalized.

Non-U.S. SD Transaction-Level Requirements – No-Action Relief

The CFTC's determination that the transaction-level requirements applied to certain swap transactions where a non-U.S. SD uses U.S. personnel to arrange,

⁴⁰ The comparability determinations for the non-EU/Japan jurisdictions also did not address clearing, real-time reporting, margin or any other transaction-level requirements.

⁴¹ CFTC No-Action Letter No. 12-56 (Dec. 17, 2012), available at <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/12-56.pdf>.

negotiate, or execute a swap was a surprise to many non-U.S. SDs. As a result of this determination, non-U.S. SDs requested that the CFTC provide some no-action relief during the time in which such non-U.S. SDs could organize their internal policies and procedures to come into compliance with the Transaction-Level Requirements.

Based on representations provided by non-U.S. SDs to the CFTC, the CFTC issued No-Action Letters No. 13-71⁴² and No. 14-01⁴³ (together, the “**TR No-Action Letters**”). The TR No-Action Letters provide relief to non-U.S. SDs⁴⁴ (whether or not an affiliate of a U.S. person) for failure to comply with any applicable “Transaction-Level Requirements”⁴⁵ when entering into swaps with non-U.S. persons that are not Guaranteed Affiliates or Conduit Affiliates of a U.S. person and such non-U.S. SDs are using personnel or agents located in the United States to arrange, negotiate, or execute such swaps (a “**Covered Transaction**”). The no-action relief provides that until September 15, 2014, the applicable CFTC enforcement divisions would not recommend that the CFTC take an enforcement action against a non-U.S. SD (whether or not an affiliate of a U.S. person) for failure to comply with:

- > any applicable Transaction-Level Requirement with respect to a Covered Transaction if the Covered Transaction is not with a non-U.S. SD; and
- > if the Covered Transaction is with a non-U.S. SD, any Transaction-Level Requirement other than (i) the multilateral portfolio compression requirements under CFTC Regulation 23.503; and (ii) the swap trading relationship requirements under CFTC Regulation 23.504.

The CFTC has also requested public comments regarding compliance issues implicated by Covered Transactions.⁴⁶

⁴² CFTC No-Action Letter No. 13-71 (Nov. 26, 2013), *available at* <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/13-71.pdf>.

⁴³ CFTC No-Action Letter No. 14-01 (Jan. 3, 2014), *available at* <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/14-01.pdf> (extended the relief provided in No-Action Letter 13-71 from January 14, 2014 to September 15, 2014).

⁴⁴ The CFTC defined “Non-U.S. SDs” who are eligible for the relief provided in the TR No-Action Letter as SDs “that are established under the laws of jurisdictions other than the United States. . .”

⁴⁵ For purposes of the TR No-Action Letters, the term “Transaction-Level Requirements” refers to the requirements set forth in Commission regulations 23.202 (Daily trading records), 23.205 (Real-time public reporting), 23.400 to 23.451 (Subpart H – Business Conduct Standards for Swap Dealers and Major Swap Participants Dealing With Counterparties, Including Special Entities), 23.501 (Swap confirmation), 23.502 (Portfolio reconciliation), 23.503 (Portfolio compression), 23.504 (Swap trading relationship documentation), 23.505 (End user exception documentation), 23.506 (Swap processing and clearing), 23.610 (Clearing member acceptance for clearing) and parts 43 (Real-time public reporting) and 50 (Clearing requirement and related rules). The TR No-Action Letters noted that (1) the CFTC has not yet finalized regulations regarding margin for uncleared swaps, (2) compliance with its regulations regarding segregation for uncleared swaps is not yet required, and (3) it has not yet determined that any swap is “available to trade” such that a trade execution requirement applies to the swap. See Exemptive Order at 43794.

⁴⁶ CFTC Release: PR6817-14 (Jan. 3, 2014), *available at* <http://www.cftc.gov/PressRoom/PressReleases/pr6817-14>.

Impact on Non-SD/MSPs?

Many non-SD/MSPs who are counterparty to SD/MSPs eligible to utilize substituted compliance will likely see little to no change going forward based on the CFTC's recent actions. Because the comparability determinations did not cover all Category A Transaction-Level Requirements,⁴⁷ swap transactions subject to such requirements would still need appropriate documentation in place which may be incorporated by either adhering to the ISDA March 2013 DF Protocol or agreeing to other documentation having the same effect. However, one category of party who may see a change are non-U.S. persons that are not SD/MSPs, Guaranteed Affiliates or Conduit Affiliates ("**Foreign Non-Registrants**"). Transactions between Foreign Non-Registrants and non-U.S. SD/MSPs did not have to comply with the transaction-level requirements, but the non-U.S. SD/MSP did have to comply with the entity-level requirements, including the SDR Reporting Requirements. As a result, Foreign Non-Registrants may have received requests to adhere to the ISDA 2013 Reporting Protocol⁴⁸ or provide similar waivers to claims of breaches of confidentiality whenever the non-U.S. SD/MSP reported swap data as required under applicable law. Due to the 13-75 Letter, such requests may have less urgency until swap data reporting is required under applicable law or the expiration of the relief provided in the 13-75 Letter. Foreign Non-Registrants and other swap market participants will also likely continue to receive requests, particularly from SD/MSPs, to fill out an ISDA Cross-Border Representation Letter⁴⁹ or otherwise make representations as to their status under the ET Guidance so that counterparties can accurately identify the regulatory status of their swap counterparties and determine if and/or what regulations apply to their swap transactions. As noted in the TR No-Action Letters, a non-U.S. SD who transacts with a U.S. person that is a Guaranteed Affiliate or Conduit Affiliate would not be able to rely on the TR No-Action Letters' relief.

⁴⁷ As such term is defined in the ET Guidance; see also Linklaters ET Guidance Note.

⁴⁸ Information regarding the ISDA 2013 Reporting Protocol is available on ISDA's website at: <https://www2.isda.org/functional-areas/protocol-management/protocol/14>.

⁴⁹ A copy of the letter is available on ISDA's website at: http://www2.isda.org/attachment/NTgyNA==/Cross_Border_Rep_Letter_Final.doc.

If you have any questions, please contact the people on the right or your usual Linklaters contacts.

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Appendix 1 – Summary Chart

UPDATED: CFTC's December 2013 Substituted Compliance Determinations and No-Action Relief

BUSINESS CONDUCT RULES for SWAP DEALERS and MAJOR SWAP PARTICIPANTS
SUMMARY OF ENTITY-LEVEL COMPARABILITY DETERMINATIONS

The following table presents, in summary form, the determinations of the Commodity Futures Trading Commission (“Commission”) that certain entity-level regulatory requirements in Australia, Canada, the European Union (“EU”), Hong Kong, Japan, and Switzerland are comparable to and as comprehensive as certain entity-level business conduct requirements for non-U.S. swap dealers and non-U.S. major swap participants under the Commodity Exchange Act and the Commission’s regulations.

<u>COMPARABILITY DETERMINATION</u>						
<u>Commission Rule</u>	<u>Australia</u>	<u>Canada</u>	<u>EU</u>	<u>Hong Kong</u>	<u>Japan</u>	<u>Switzerland</u>
Chief Compliance Officer § 3.3	Comparable (Notes 1, 2)	Comparable (Note 2)	Comparable (Note 2)	Comparable (Note 2)	Comparable (Note 2)	Comparable (Note 2)
Swap Data Recordkeeping §§ 23.201, 23.203	Comparable (Note 4)	Comparable (Note 4)	Comparable (Note 4)	Comparable (Note 4)	Comparable	Comparable (Note 4)
Risk Management Program § 23.600	Comparable (Note 3)	Comparable (Note 3)	Comparable (Note 3)	Comparable (Note 3)	Comparable (Note 3)	Comparable (Note 3)
Monitoring of Position Limits § 23.601	Comparable	Comparable	Comparable	Comparable	Comparable	Comparable
Diligent Supervision § 23.602	Comparable	Comparable	Comparable	Comparable	Comparable	Comparable
Business Continuity § 23.603	Comparable	Comparable	Comparable	Comparable	Comparable	Comparable
Research Conflicts § 23.605(c)	Comparable	Comparable	Comparable	Comparable	Comparable	Comparable

<u>COMPARABILITY DETERMINATION</u>						
<u>Commission Rule</u>	<u>Australia</u>	<u>Canada</u>	<u>EU</u>	<u>Hong Kong</u>	<u>Japan</u>	<u>Switzerland</u>
Clearing Conflicts § 23.605(d)	Comparable	Comparable	Comparable	Comparable	Comparable	Comparable
Undue Influence § 23.605(e)	Comparable	Comparable	Comparable	Comparable	Comparable	Comparable
Availability of Information for Disclosure § 23.606	Comparable (Note 4)	Comparable (Note 4)	Comparable (Note 4)	Comparable (Note 4)	Comparable	Comparable (Note 4)
Clearing Member Risk Management § 23.609	Comparable	Comparable	Comparable	No Determination	Comparable	No Determination

Note 1: Other than for § 3.3(e), which requires a swap dealer or MSP to produce an annual compliance report and stipulates the content thereof.

Note 2: Other than for § 3.3(f), which requires (i) the CEO or CCO of a swap dealer or MSP to certify that the annual compliance report is accurate and complete, and (ii) the annual compliance report to be furnished to the Commission.

Note 3: Other than for § 23.600(c)(2), which requires a swap dealer or MSP to produce quarterly risk exposure reports and provide such reports to its senior management, governing body, and the Commission.

Note 4: The Commission reserves the right to require a swap dealer or MSP to provide direct access to or produce records required to be maintained under the CEA and Commission regulations to Commission staff, the staff of an applicable U.S. prudential regulator, or the U.S. Department of Justice.