HOGAN LOVELLS

Corporate practice memorandum

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Evan M. Koster
Partner, New York
evan.koster@hoganlovells.com
+1 212 918 8260

Daniel S. Meade
Partner, Washington, D.C.
daniel.meade@hoganlovells.com
+1 202 637 5664

Stuart G. Stein
Partner, Washington, D.C.
Co-Leader, Corporate Practice Group
stuart.stein@hoganlovells.com
+1 202 637 8575

David J. Cohn
Associate, New York
david.cohn@hoganlovells.com
+1 212 918 3293

Gregory B. Hafkin
Associate, New York
gregory.hafkin@hoganlovells.com
+1 212 918 3638

“End-Users Gear Up for Dodd-Frank Compliance as Commissions Issue Rules and ISDA Announces Dodd-Frank Documentation Protocol”

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I. BACKGROUND

It has been a very busy summer for regulators of the U.S. swap markets and derivatives market participants. In mid-June, the Commodities Futures Trading Commission (the "CFTC") issued rules for swap data recordkeeping and reporting requirements for pre-enactment and transition swaps. In late June the CFTC issued proposed guidance on the cross-border application of the Commodities Exchange Act ("CEA"). In July, the CFTC issued the final rules regarding clearing and the commercial end-user exception. On August 21 the CFTC issued a proposed rule regarding an exception from the clearing requirement for inter-affiliate swaps and on August 13 the long-awaited final rules of the Securities and Exchange Commission (the "SEC"; together with the CFTC, the "Commissions") and the CFTC defining "swap", "security-based swap" and other defined terms were published.

In terms of timing, it is the latter rule that has the most significance, because its publication in the Federal Register starts the clock ticking for compliance dates for many of the key derivatives regulations of the Dodd-Frank Act (the "DFA"). Ever since the DFA was enacted in July 2010, banking institutions and derivatives dealers have paid close attention to their compliance responsibilities. The flurry of activity in August, however, also means that non-banking institutions, from energy to tech to other industrial companies, must also consider as to whether and how their derivatives trading and compliance requirements, which may previously have been minimal, if any, will now change.

The starting point for their analysis should be whether their trading activity involves "swaps" and "security-based swaps" as those terms are defined by the Commissions. Agreements, contracts or transactions included within the statutory definitions of swap and security-based swap are referred to collectively as "Title VII Derivative Instruments." Section IV below goes into detail on the definitions of these terms.

If your firm's trading activity is in fact covered, then the clearing requirement of the DFA could potentially have a significant impact. However, there are two potential exceptions which could be applicable, the commercial end-user exception and the inter-affiliate exception, described in Sections VI and VII respectively. If one or both of these exceptions do apply then the principal direct effect of these rules on your compliance requirements will be with respect to recordkeeping and reporting, which are covered in Section V below. Please note that there may be DFA compliance requirements even if you trade overseas or with a non-U.S. counterparty; therefore, in Section VIII we review the CFTC's proposed guidance on cross-border swaps. Finally, we set forth the key compliance dates that will apply to derivatives market participants in Section IX.

The last section, Section X, describes what documentation changes may be in store and describes a process developed by the International Swaps and Derivatives Association ("ISDA") to streamline the amendment process through adherence to a multilateral protocol.

Lastly, while the CFTC has finalized the compliance schedule for these rules, news reports in the first week of September indicated that certain compliance dates, including those relating to the registration of swap dealers and major swap participants, will be delayed to January 2012. Thus, while we list the compliance dates in effect as of the date of this memorandum, clients ought to be aware that such dates are subject to change.

II. WHAT YOU NEED TO DO NOW

- Review your trading activity to see whether you trade "swaps" or "security-based swaps" as defined under relevant federal law.

- Quantify your outstanding swaps and security-based swaps - what is the outstanding aggregate notional amount and aggregate mark-to-market both gross and net of collateral posted?

- Determine whether you are a financial entity. This may cover banking institutions, insurance companies, hedge funds and ERISA plans.

- If you are not a financial entity, swap dealer or a major swap participant - check to see whether you are eligible for an exception from the clearing requirement.

    - Are you using swaps for hedging purposes?

    - Are your swaps with affiliates?

    - You will need a specific board or committee of the board resolution to take advantage of these exceptions from clearing.

- Check your recordkeeping of swaps.

    - Have you been maintaining them for five years? What information have you been keeping, and in what format? You may have to begin keeping more detailed information.

- Prepare for reporting.

    - Are your uncleared swaps with swap dealers/major swap participants or with other end-users? If they are with other end-users, you may have to modify your existing documentation to designate a reporting party.

- If you have swaps with swap dealers, they may be preparing to amend your documents to keep up with regulatory changes. Contact them to find out if they are. They should provide you with sufficient time to review amendments.

III. EXECUTIVE SUMMARY

The definition of swap includes standard derivative transactions such as interest rate swaps, currency swaps, total return swaps, foreign exchange swaps, credit default swaps, energy swaps and commodity swaps. Certain transactions are outside the definition, including certain insurance contracts, certain types of consumer and commercial transactions and forward contracts. The SEC has also enacted provisions for security-based swaps.

Swap participants, including in some instances commercial end users, will need to comply with various recordkeeping and reporting requirements. Some swaps that were entered into prior to the enactment of the DFA will also need to be reported. Furthermore, the CFTC has exempted certain types of swaps from the clearing requirement, including those swaps where one of the counterparties is a non-financial entity that is using the swap to hedge or mitigate commercial risk and swaps between affiliates.

The CFTC has issued proposed guidance as to the cross-border effect of the DFA, indicating that the DFA would apply to transactions involving U.S. persons even if the swaps are executed overseas with foreign swap dealers. However, the CFTC is considering allowing certain transactions to be subject to a foreign regime instead of the DFA under limited circumstances.

To the extent parties have existing agreements that do not comply with the DFA, ISDA has issued a protocol that will provide a streamlined approach to amending documentation.

IV. WHAT IS A SWAP?

On July 10, 2012, the Commissions published final rules (the "Final Rules")[1] and interpretive guidance (the "Adopting Release") under Title VII of the DFA defining "swap," "security-based swap," "security-based swap agreement" and regulations relating to mixed swaps and security-based swap agreements. The Final Rules generally adopt, without modification, the rules (the "Proposed Rules") and guidance (the "Proposing Release") proposed by the Commissions in May 2011.[2]

The Final Rules will become effective on October 12, 2012. The Final Rules also trigger the effectiveness of other rules promulgated under the DFA, including those rules pertaining to (i) registration of swap dealers and major swap participants ("MSPs"), which will become effective on October 12, 2012, (ii) swap data reporting and recordkeeping for non-cleared swaps (for entities that are not swap dealers or MSPs), which will become effective on April 10, 2013, and (iii) position limits for certain physical commodity futures contracts and their economic equivalents, which will become effective on October 12, 2012.

The DFA divided jurisdiction over the over-the-counter derivatives market between the CFTC and the SEC granting, with some exceptions, the CFTC jurisdiction over swaps and the SEC jurisdiction over security-based swaps.

A swap is defined to include, among other things, any agreement, contract or transaction involving the "purchase, sale, payment or delivery that is dependent on the occurrence, nonoccurrence or extent of occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence."[3] This definition includes standard derivative transactions such as interest rate swaps, currency swaps, total return swaps, foreign exchange swaps, credit default swaps, energy swaps and commodity swaps. The definition also excludes certain transactions, including security-based swaps.

A security-based swap is defined as an agreement, contract or transaction that is a swap and is based on (i) an index that is a narrow-based security index, including any interest therein or on the value thereof, (ii) a single security or loan, including any interest therein or on the value thereof, or (iii) the occurrence, nonoccurrence or extent of occurrence, nonoccurrence, or the extent of the occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index, provided that such event directly affects the financial statements, financial condition, or financial obligations of the issuer."[4]

1. TRANSACTIONS OUTSIDE OF THE SCOPE OF DEFINITIONS OF SWAP AND SECURITY-BASED SWAP

The Commissions recognize that certain types of insurance products and consumer and commercial transactions could be categorized as Title VII Derivative Instruments, but that Congress did not intend such a result. Thus, the Commissions created a non-exclusive safe harbor for certain insurance products and have excluded certain types of consumer and commercial transactions. Additionally, the definitions of swap and security-based swaps exclude forward contracts.

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[1] "Further Definition of 'Swap,' 'Security-Based Swap,' and 'Security-Based Swap Agreement'; Mixed Swaps; Security-Based Swap Agreement Recordkeeping," 77 Federal Register 156 (13 August 2012), pp. 48208-48366. http://cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-18003a.pdf.
[2] "Further Definition of 'Swap,' 'Security-Based Swap,' and 'Security-Based Swap Agreement'; Mixed Swaps; Security-Based Swap Agreement Recordkeeping," 76 Federal Register 99 (23 May 2011), pp. 29818-29900. http://cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-11008a.pdf.
[3] CEA, section 1a(47)(A).
[4] Securities Exchange Act of 1934 (the "Exchange Act"), section 3(a)(68)(A).

A. Insurance Safe Harbor

The Commissions believe that Congress did not intend for traditional insurance products to be regulated as swaps or security-based swaps. State or federally regulated insurance products that are provided by persons subject to state or Federal insurance supervision, that could otherwise be considered Title VII Derivative Instruments, will not be considered to be Title VII Derivative Instruments so long as they satisfy the requirements for the safe harbor tests: (i) the Product Test, (ii) the Provider Test or (iii) the Enumerated Products Test. The safe harbor is non-exclusive, meaning that even if a product fails to satisfy the tests, it still may not be a Title VII Derivative Instrument. Further analysis of the facts and circumstances, including the form and substance of the agreement, contract or transaction, would be required. One consideration the Commissions will take into account is prior regulation as an insurance contract. The insurance safe harbor also includes a Grandfather Exclusion for transactions entered into on or before October 12, 2012, provided that certain other requirements are met.

i. Product Test

An agreement, contract or transaction that satisfies all of the requirements of the Product Test and satisfies any prong of the Provider Test will fall within the insurance safe harbor and not be subject to regulation as a Title VII Derivative Instrument. A Title VII Derivative Instrument will not include an agreement, transaction or contract that, by its terms or by law:

- requires the beneficiary of the agreement, contract, or transaction to have an insurable interest that is the subject of the agreement, contract, or transaction and thereby carry the risk of loss with respect to that interest continuously throughout the duration of the agreement, contract, or transaction;
- requires that loss to occur and be proved, and that any payment or indemnification therefor be limited to the value of the insurable interest;
- is not traded, separately from the insured interest, on an organized market or over-the-counter; and
- with respect to financial guaranty insurance only, in the event of payment default or insolvency of the obligor, any acceleration of payments under the policy is at the sole discretion of the insurer.

With respect to the first prong, a credit default swap ("CDS") would not satisfy the Product Test because the protection buyer is not required to own the underlying obligation on which the CDS is written. The Commissions believe that this is a meaningful way to distinguish between swaps and insurance. Regarding the third prong, the Adopting Release clarifies that assignments of insurance contracts as permitted or required by state law, or the purchase or assignment of an insurance contract on an insurance exchange or otherwise does not constitute trading an agreement separately from the insured interest and, thus, would not violate the trading restriction.

ii. Provider Test

The Provider Test requires that, in order to be eligible for the insurance safe harbor, any product that satisfies the Product Test must be provided:

- by a person that is subject to supervision by the insurance commissioner (or similar official or agency) of any state or by the U.S. or an agency or instrumentality thereof, and the product is regulated as insurance under applicable state law or the laws of the U.S.;
- directly or indirectly by the U.S., any state or any of their respective agencies or instrumentalities, or pursuant to a statutorily authorized program thereof;
- in the case of reinsurance only, by a person to another person that satisfies the Provider Test, provided that (i) the person is not prohibited by applicable state law or the laws of the U.S. from offering the product to such person that satisfies the Provider Test, (ii) the product to be reinsured satisfies the Product Test and

(iii) except as otherwise permitted under applicable state law, the total amount reimbursable by all reinsurers for such product may not exceed the claims or losses paid by the cedant; or

- in the case of non-admitted insurance, by a person who (i) is located outside of the U.S. and is listed on the Quarterly Listing of Alien Insurers as maintained by the International Insurers Department of the National Association of Insurance Commissioners or (ii) meets the eligibility criteria for non-admitted insurers under applicable state law.

iii. Enumerated Products Test

A product will not be considered a Title VII Derivative Instrument if it satisfies the Provider Test and is a surety bond, fidelity bond, life insurance, long term care insurance, health insurance, title insurance, property insurance, casualty insurance, disability insurance, annuity, insurance against default on individual residential mortgages, and reinsurance or retrocession of any of the foregoing.

iv. Grandfather Exception

A product will not be considered a Title VII Derivative Instrument if it was entered into on or before October 12, 2012 and was provided by a person who satisfies the Provider Test.

v. Guarantees of Title VII Derivative Instruments

The CFTC believes that the guarantee or insurance of a product that falls within the swap definition (and is not a security-based swap or mixed swap) is functionally or economically similar to a guarantee of a swap (that is not a security-based swap or mixed swap) and will be treated as other guarantees of swaps (that are not security-based swaps or mixed swaps), i.e., guarantees of swaps are swaps if the counterparty to the guaranteed swap would have recourse to the guarantor in connection with the swap position. The CFTC noted that it will issue further guidance on this issue.

The SEC has elected not to treat guarantees of security-based swaps as separate security-based swap transactions or as part of the security-based swaps that they guarantee. The SEC may consider additional reporting requirements with respect to security-based swap guarantees as part of its overall reporting requirements. A guarantee of a security is also a security, however, and thus a guarantee of a security-based swap would be treated as a security under federal securities laws.

B. Forward Contract Exclusion

The definitions of swap and security-based swap exclude "any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled." The forward exclusion does not apply to the commodities themselves, but rather to certain types of agreements, contracts or transactions in a specified type of commodity. The Commissions provide guidance on the exclusion of non-financial commodities and securities under the DFA. Energy transactions that may qualify for the forward contract exclusion, if they satisfy certain criteria, include:

- Forward contract book-outs;
- Environmental commodities;
- Physical exchange transactions;
- Fuel delivery agreements;
- Forward contracts with embedded commodity options;
- Forward contracts with embedded volumetric commodity options; and
- Physical commercial agreements.

i. CFTC Guidance

a. Nonfinancial Commodities

A "nonfinancial commodity" is a commodity that (i) can be physically delivered and (ii) is an exempt commodity or an agricultural commodity. An "exempt commodity" is a commodity that is not an excluded commodity or agricultural commodity. An energy commodity is an example of an exempt commodity. "Excluded commodities" are generally financial (e.g., interest rates, exchange rates, currencies and securities indexes other than narrow-based securities indexes). In the Adopting Release, the CFTC interprets that an intangible commodity (that is not an excluded commodity) which can be physically delivered qualifies as a nonfinancial commodity if ownership of the commodity can be conveyed in some manner and the commodity can be consumed (e.g., an environmental commodity such as an emission allowance).

b. Forward Contracts in Nonfinancial Commodities

The CFTC will interpret the forward exclusion for nonfinancial commodities consistently with its historical interpretation of the existing forward exclusion with respect to futures contracts. The CFTC's historical interpretation has been that forward contracts with respect to nonfinancial commodities are "commercial merchandising transactions" and generally not subject to the CEA.

Book-out transactions in nonfinancial commodities that meet the requirements specified in the CFTC's "Brent Interpretation" that are effectuated through a subsequent, separately negotiated agreement will qualify for the forward exclusion under the swap definition. Under the Brent Interpretation, the CFTC concluded that separate, individually negotiated cancellation agreements referencing existing crude oil contracts were forward contracts rather than futures contracts and, thus, were excluded from CFTC regulation.

In the Adopting Release, the CFTC has clarified that commercial market participants that regularly make or take delivery of the referenced commodity in the ordinary course of their business will meet the commercial participant standard of the Brent Interpretation and will qualify for the forward exclusion from both the future delivery and swap definitions for their forward transactions in nonfinancial commodities. This will hold even if the parties enter into a subsequent book-out transaction, so long as:

- the original contract created a binding obligation to make or take physical delivery without providing any right to offset, cancel or settle on a payment-of-differences basis;
- the original contract was between commercial parties that regularly make or take delivery of the referenced commodity in their ordinary course of business;
- the book-out, offset, cancellation or settlement on a payment-of-differences basis is effectuated through a subsequent, separately negotiated agreement; and
- in the event of an oral agreement, such agreement is followed in a commercially reasonable timeframe by a confirmation in written or electronic form.

c. Environmental Commodities

Environmental commodity transactions that satisfy the definition of a nonfinancial commodity may qualify for the forward exclusion from the swap definition, so long as the transaction is intended to be physically settled. Environmental commodities include emission allowances, carbon offsets and renewable energy credits. The CFTC declined to provide a definition for environmental commodities, stating that an intangible commodity – environmental or otherwise – that satisfies the definition of "nonfinancial commodities" would be a nonfinancial commodity and, thus, eligible for the forward exclusion from the swap definition.

d. Physical Exchange Transactions

Physical exchange transactions, to the extent they are for deferred delivery, may be within the forward exclusion from the definition of "swap" and "future delivery." For an exchange transaction to fall within the forward exclusion, the parties must intend for the transaction to be physically settled, and the exchange transaction must satisfy all applicable interpretations, including that relating to book-outs.

The CFTC provided an example of an excluded exchange transaction where a gas utility enters into a transaction with another gas utility or other market participant to take delivery of natural gas at one delivery point in exchange for delivery of the same quantity of gas at a different delivery point for the primary purpose of transferring ownership of the physical commodity in order to rationalize the delivery of physical supplies to where they are needed at a price generally reflecting the difference in value at the delivery points.

e. Fuel Delivery Agreements

The CFTC will treat fuel delivery agreements as forwards if the agreements do not contain any optionality other than as permitted in the CFTC's interpretation. Monthly or other fees that are not in the nature of option premiums do not convert the transactions from forwards to options. In an example provided by the CFTC of a fuel delivery agreement that would be treated as a forward, a joint power agency provides a municipal utility with a long-term supply of natural gas from a natural gas project developed by the joint power agency and other entities to provide fuel for the joint power agency's and municipal utility's facilities. The municipal utility would pay the joint power agency through direct capital contributions to the developers for developing costs and through a monthly fee for the supplied natural gas.

f. Cleared/Exchange-Traded Forwards

The CFTC declined to address a request for a safe harbor for exchange-traded contracts with respect to which 50% of contracts go to delivery and 100% of the counterparties are commercial counterparties because it raises policy issues beyond the scope of the definitional rulemaking. If the CFTC examines the issue at a later date, it would seek public comment.

ii. Commodity Options and Commodity Options Embedded in Forward Contracts

Commodity options are explicitly included in the statutory definition of swaps, but forward contracts with embedded commodity options may qualify for exclusion. The CFTC will apply its 1985 CFTC OGC Interpretation to the treatment of forward contracts in nonfinancial commodities with embedded commodity options. The CFTC will engage in a two-step analysis of embedded options in which the first step focuses on whether the option operates on the price or delivery term of the forward contract and the second step focuses on secondary trading.

A forward contract that contains an embedded commodity option will be an excluded nonfinancial commodity forward contract (and not a swap) if the embedded option:

- may be used to adjust the forward contract price, but does not undermine the overall nature of the contract as a forward contract;
- does not target the delivery term, so that the predominant feature of the contract is actual delivery; and
- cannot be severed and marketed separately from the overall forward contract in which it is embedded.

The CFTC also provided an interpretation that a transaction containing embedded volumetric optionality may satisfy the forward exclusion when:

- the embedded optionality does not undermine the overall nature of the agreement, contract, or transaction as a forward contract;
- the predominant feature of the agreement, contract, or transaction is actual delivery;
- the embedded optionality cannot be severed and marketed separately from the overall agreement, contract, or transaction in which it is embedded;
- the seller of a nonfinancial commodity underlying the agreement, contract, or transaction with embedded volumetric optionality intends, at the time it enters into the agreement, contract, or transaction to deliver the underlying nonfinancial commodity if the optionality is exercised;
- the buyer of a nonfinancial commodity underlying the agreement, contract or transaction with embedded volumetric optionality intends, at the time it enters into the agreement, contract, or transaction, to take delivery of the underlying nonfinancial commodity if it exercises the embedded volumetric optionality;
- both parties are commercial parties; and
- the exercise or non-exercise of the embedded volumetric optionality is based primarily on physical factors, or regulatory requirements, that are outside the control of the parties and are influencing demand for, or supply of, the nonfinancial commodity.

a. Physical Commercial Agreements

The CFTC will view physical commercial agreements for the supply and consumption of energy that provide flexibility (e.g., tolls on power plants, transportation agreements on natural gas pipelines and natural gas storage agreements) to not be options when:

- the subject of the agreement, contract or transaction is usage of a specified facility or part thereof rather than the purchase or sale of the commodity that is to be created, transported, processed or stored using the specified facility;
- the agreement, contract or transaction grants the buyer the exclusive use of the specified facility or part thereof during its term, and provides for an unconditional obligation on the part of the seller to grant the buyer the exclusive use of the specified facility or part thereof; and
- the payment for the use of the specified facility or part thereof represents a payment for its use rather than the option to use it.

b. Energy Management Agreements

The CFTC declined to categorically state whether energy management agreements ("EMA"), which are not defined in the Adopting Release and which can be used to cover a number of services and transactions, are swaps. However, if the transaction executed under an EMA is not a swap, the use of an EMA should not convert it into a swap. Conversely, if a swap was executed as a result of, or pursuant to, an EMA, the parties would need to consider whether any swap-related regulations were applicable (e.g., registration).

c. Liquidated Damages Clauses

The CFTC clarified that the inclusion of a liquidated damages provision in a transaction involving physical settlement of a nonfinancial commodity does not necessarily render the transaction ineligible for the forward exclusion. Such a provision is consistent with the use of the forward exclusion, provided the parties intend the transaction to be physically-settled.

C. Consumer and Commercial Transactions

The Final Rules state that transactions entered into by consumers primarily for personal, family or household purposes and customary business and commercial arrangements will not be considered to be Title VII Derivative Instruments.

Consumer transactions that would not be Title VII Derivative Instruments include, among others, transactions to acquire or lease real or personal property, to obtain a mortgage, provide personal services, or for interest rate caps or locks on consumer loans or mortgages or variable interest rate consumer loans or mortgages.

Commercial transactions outside the scope of the Final Rules include, among others, employment contracts and retirement benefit arrangements, sales, servicing or distribution arrangements, warehouse lending arrangements in connection with building an inventory of assets in anticipation of securitization and mortgage or mortgage purchase commitments.

In determining whether a consumer or commercial transaction should be a Title VII Derivative Instrument, the Commissions will consider:

- that they do not contain payment obligations, whether or not contingent, that are severable from the agreement, contract, or transaction;
- that they are not traded on an organized market or over-the-counter; and
- in the case of consumer arrangements, they:
  - involve an asset of which the consumer is the owner or beneficiary, or that the consumer is purchasing, or they involve a service provided, or to be provided, by or to the consumer, or
- in the case of commercial arrangements, they are entered into:
  - by commercial or non-profit entities as principals (or by their agents) to serve an independent commercial, business, or non-profit purpose, and
  - other than for speculative, hedging or investment purposes.

D. Loan Participations

Loan participations that reflect an ownership interest in the underlying loan or commitment are not Title VII Derivative Instruments. Loan participations arise when a lender transfers or offers a participation in the economic risks and benefits of all or a portion of a loan or commitment it has entered into with a borrower to another party as an alternative or precursor to assigning to such person the loan or commitment or an interest in the loan or commitment. There are two types of loan participations: (i) LSTA-style participations and (ii) LMA-style participations. LSTA-style participations transfer a beneficial ownership interest in the underlying loan or commitment to the participant. LMA-style participations do not transfer a beneficial ownership interest in the underlying loan or commitment to the participant, but rather create a debtor-creditor relationship between the grantor and the participant under which a future beneficial ownership interest is conveyed. In evaluating whether the loan participation represents an ownership interest, the Commissions will look for the presence of the following characteristics:

- The grantor of the loan participation is a lender under, or a participant or sub-participant in, the loan or commitment that is the subject of the loan participation.
- The aggregate participation in the loan or commitment that is the subject of the loan participation does not exceed the principal amount of such loan or commitment. Further, the loan participation does not grant, in the aggregate, to the participant in such loan participation a greater interest than the grantor holds in the loan or commitment that is the subject of the loan participation.
- The entire purchase price for the loan participation is paid in full when acquired and not financed.

- The loan participation provides the participant all of the economic benefit and risk of the whole or part of the loan or commitment that is the subject of the loan participation.

2. FOREIGN EXCHANGE PRODUCTS

Foreign exchange forwards and foreign exchange swaps are swaps under the Final Rules, unless the Secretary of the U.S. Department of the Treasury issues a written determination that either product should not be regulated as a swap. The Secretary has not made a determination yet. Even if the Secretary determines that one or both products are not swaps, transactions in the products will still be subject to swap reporting requirements, and swap dealers and MSPs engaging in such transactions will remain subject to certain business conduct standards. Notwithstanding the Secretary's determination, other types of foreign exchange products (e.g., foreign currency options, non-deliverable forward contracts, currency swaps and cross-currency swaps) will be regulated as swaps.

A. Foreign Exchange Swap Transactions

The CFTC does not have regulatory jurisdiction of foreign exchange spot transactions under the CEA, and while the new definition of "foreign exchange forward" could be read to apply to any foreign exchange transaction that does not settle on the same day, the CFTC does not intend to treat bona fide foreign exchange spot transactions as swaps. To receive this treatment, spot transactions must settle on the timeline customary in the relevant spot market (typically 2 business days), but spot transactions with longer settlements will be eligible if customary in the particular market.

B. Retail Foreign Currency Options

Retail foreign currency options are not included within the swap definition so long as they satisfy the description in Section 2(c)(2)(B) of the CEA.

C. Forward Rate Agreements

Notwithstanding their "forward" label, forward rate agreements (over-the-counter contracts for a single cash payment, due on the settlement date of a trade, based on a spot rate and a pre-determined forward rate) are swaps.

D. Combinations and Permutations of, or Options on, Swaps and Security-Based Swaps

Combinations and permutations of, or options on, swaps and security-based swaps are swaps.

E. Contracts for Differences

Contracts for differences, unless otherwise excluded, are Title VII Derivative Instruments. Whether a contract for differences is a swap or security-based swap will depend on the underlying product of each particular contract for differences transaction and, thus, market participants will need to analyze each such transaction to determine if it is a Title VII Derivative Instrument or if it is excluded.

3. RELATIONSHIP BETWEEN THE SWAP AND SECURITY-BASED SWAP DEFINITIONS

The determination of whether a Title VII Derivative Instrument is a swap or a security-based swap should be made based on the facts and circumstances of the Title VII Derivative Instrument prior to execution, but no later than when the parties offer to enter into the transaction. Transactions that are not amended, modified or otherwise adjusted will retain their original characterization for the life of the transaction. While this determination will generally be straightforward, the Commissions recognize that it may be complex for some transactions and have provided interpretations for certain types of transactions.

A. Products based on Interest Rates, Other Monetary Rates and Yields

i. Interest rates and other monetary rates

A Title VII Derivative Instrument with payments based solely on levels of certain interest rates or other monetary rates that are not themselves based on one or more securities will be treated as swaps. Examples include interbank offered rates, money market rates, government target rates, general lending rates, other monetary rates, such as the consumer price index, and other rates for which the volatility, variance or rate of change is based on any of the foregoing or averages of such rates.

ii. Yields

Title VII Derivative Instruments based on yields, where the yield is a proxy for the price or value of a debt security, loan or narrow-based security index product, will be treated as security-based swaps. In addition, where yield is a point on a yield curve generated from different yields on debt securities in a narrow-based index, the Title VII Derivative Instrument would be a security-based swap. Where the yield is not based on a debt security, loan or narrow-based security index, but is used to reference an interest rate or monetary rate, yield is equivalent to an interest rate or monetary rate, and the Title VII Derivative Instrument would be a swap or a mixed-swap.

iii. Title VII Derivative Instruments based on Government Debt Obligations

If the only underlying reference of a Title VII Derivative Instrument involving securities is, for example, the price of a U.S. Treasury security and the instrument does not have any other underlying reference involving securities, then the instrument would be a swap. Similarly, if the Title VII Derivative Instrument is based on the yield of a U.S. Treasury security and does not have any other underlying reference involving securities, then the instrument also would be a swap, regardless of whether the term "yield" is a proxy for the price of the security. If the underlying reference of the Title VII Derivative Instrument is the price, value, or yield (where yield is a proxy for price or value) of a foreign government security, or a point on a yield curve derived from a narrow-based security index composed of foreign government securities, then the instrument is a security-based swap

B. Total Return Swaps

A total return swap ("TRS") on a single security or loan or narrow-based security index is a security-based swap. TRS that include features that create additional interest rate or currency exposures that are unrelated to the financing of the TRS or otherwise shift or limit risks that are related to the financing of the security-based swap may cause it to be a mixed swap. A TRS on a broad-based security index, on two or more loans or an exempted security (other than municipal securities) is a swap.

C. Security-based Swaps on a Single Security or Loan and Single-Name CDS

Single-name CDS referencing a single reference obligation are security-based swaps. A CDS which is triggered by an event relating to financial statements, financial condition or financial obligations of a single security issuer is a security-based swap.

D. Title VII Derivative Instruments Based on Futures Contracts

Title VII Derivative Instruments based on futures contracts may be swaps, security-based swaps or mixed swaps depending on the nature of the futures contract, including the underlying reference of the futures contract. Where the underlying reference is a security future, the Title VII Derivative Instrument is a security-based swap. Where the underlying reference is a futures contract that is not a security future, the Title VII Derivative Instrument is a swap. Futures contracts based directly on certain foreign government debt securities and satisfying certain conditions are swaps.

E. Use of Certain Terms in Title VII Derivative Instruments

The Commissions recognize that fixed terms of Title VII Derivative Instruments are often informed by the value or level of a security, rate or other commodity at the time of execution of the transaction. The nature of the security, rate or other commodity that informed the fixed terms will not itself impact the determination of whether the Title VII Derivative Instrument is a swap or security-based swap, provided that the fixed term is set at the time of execution and remains constant over the life of the transaction.

For example, an interest rate swap with a floating leg based on 3-month LIBOR and a fixed leg of 5% would be a swap, rather than a security-based swap, even if the fixed rate was informed by, or quoted based on, the yield of a security, so long as the fixed rate was set at execution and remained constant over the life of the swap.

F. "Narrow-Based Security Index" in Security-Based Swap Definition

As defined in section 1a(35) of the CEA and section 3(a)(55) of the Exchange Act, an index is a narrow-based security index if, among other things, it meets any one of the following criteria:

- it has nine or fewer component securities;
- a component security comprises more than 30 percent of the index's weighting;
- the five highest weighted component securities in the aggregate comprise more than 60 percent of the index's weighting; or
- the lowest weighted component securities comprising, in the aggregate, 25 percent of the index's weighting have an aggregate dollar value of average daily trading volume of less than $50,000,000 (or in the case of an index with more than 15 component securities, $30,000,000).

The Commissions recognize that the statutory definition is focused on equity indexes, but they have in the past extended the definition to volatility indexes and debt security indexes. The Commissions are adopting a rule that, except for index CDS, their prior guidance on volatility and debt security indexes is applicable in determining whether a security index is narrow-based.

G. Narrow-Based Security Index Criteria for Index CDS

A CDS where the underlying reference is a single entity (i.e., a single-name CDS), or a single obligation of a single entity (e.g., a CDS on a specific bond, loan or asset-backed security, or any tranche or series of a bond, loan or asset-backed security), or an index CDS where the underlying reference is a narrow-based security index or the issuers of securities in a narrow-based security index, is a security-based swap. An index CDS where the underlying reference is not a narrow-based security index or the issuers of securities in a narrow-based security index (i.e., a broad-based security index) is a swap.

The Commissions recognize that the statutory definition of "narrow-based security index" is not appropriate for determining whether an index underlying an index CDS is broad-based or narrow-based because the definition was designed for the equity markets. As a result, the Commissions have adopted rules that include separate criteria for determining whether an index underlying an index CDS is a narrow-based security index.

i. Number and concentration percentages of reference entities or obligations

Where an index CDS is based on the issuers of securities in a security index, the underlying index will be a narrow-based security index if:

- there are nine or fewer non-affiliated issuers of securities that are referenced in the index;
- the notional amount allocated to any entity included in the index comprises more than thirty percent of the index's weighting; or
- the notional amount allocated to any five non-affiliated entities included in the index comprises more than sixty percent of the index's weighting.

These conditions also apply in determining whether an index CDS based on issuers or reference entities is a security-based swap based on a narrow-based security index. The securities of an issuer must be aggregated with its own securities or securities of an affiliate also included in the index for determining whether an index meets any of the above conditions.

ii. Affiliation of reference entities and issuers of securities with respect to index CDS

The Final Rules provide that a reference entity or issuer of securities included in an index and any of that reference entity's affiliated entities that also are included in the index are aggregated for purposes of determining whether the number and concentration conditions are met. A reference entity or issuer of securities included in an index is affiliated with another reference entity or issuer of securities included in the index if it controls, is controlled by, or is under common control with, that other reference entity or issuer. Control, solely for purposes of this definition of affiliate, means:

- ownership of more than 50% of an entity's or issuer's equity or
- the ability to direct the voting of more than 50% or more of an entity's or issuer's voting equity.

in response to comments from market participants, the Commissions modified the Proposing Release which had set a threshold percentage for ownership at 20%.

iii. Public information availability regarding reference entities and securities

The Commissions require a public information availability test in the definition of narrow-based security index for index CDS, rather than an average daily trading volume test ("ADTV") as is used in the debt security index test because index CDS commonly reference entities that do not "trade" or debt instruments that commonly are not listed, and therefore, do not have a significant trading volume for which an ADTV test would be useful. The goal of the public availability test is to ensure that there is publicly available information concerning the reference entities or issuers of securities in the index.

Under the Final Rules, an index CDS will be based on a narrow-based security index if any reference entity or issuer of a security included in the index does not meet any of the following conditions:

- it is required to file Exchange Act reports;
- it is eligible for an exemption pursuant to Exchange Act Rule 12g3-2(b);
- it has a worldwide market value of outstanding common equity held by non-affiliates of $700 million or more;
- other than a reference entity in an index that is the issuing entity of asset-backed securities, it has outstanding notes, bonds, debentures, loans or evidence of indebtedness (other than revolving credit facilities) with an aggregate outstanding principal amount of at least $1 billion;
- it is an issuer of an exempted security, other than a municipal security, as defined in section 3(a)(12) of the Exchange Act, or an exempted security other than a municipal security is included in the index;

- it is a government of a foreign country or political subdivision thereof; or
- it is an issuer of registered asset-backed securities and has publicly available distribution reports.

However, if all the other entities or securities in the index that satisfy the public information availability test make up at least 80% of the index's weighting and the failing reference entity or security comprises less than 5% of the index's weighting, the index will not be narrow-based. The Commissions' rationale is that information about a predominant percentage of the reference entities or securities in the index will be publicly available, making manipulation less likely.

When determining whether a reference entity or issuer of securities included in the index satisfies the public information availability test, market participants should look to whether the reference entity or issuer, when aggregated with its affiliates, satisfies any of the conditions of the test. Thus, an index CDS will not be based on a narrow-based security index so long as no reference entity or issuer of securities included in the index or any affiliate of such entity or issuer:

- is required to file reports under the Exchange Act;
- is eligible to rely on a foreign private issuers exemption under the Exchange Act;
- has, when aggregated with affiliates, outstanding common equity held by non-affiliates of $700 million or more;
- has, when aggregated with affiliates, notes, bonds, debentures, loans, or evidence of indebtedness (other than revolving credit facilities) of at least $1 billion.

In the case of asset-backed securities, however, the issuing entity that is a reference entity or an issuer of such securities included in the index underlying the CDS is looked at individually and is not aggregated with its affiliates to determine if it satisfies one of the public information availability tests.

iv. Treatment of indexes including exempted securities or issuers thereof

Exempted securities and issuers thereof should be excluded from the index when determining whether the securities or reference entities in the index constitute a narrow-based security index. An index composed solely of securities that are, or reference entities that are issuers of, exempted securities (other than municipal securities) will not be a narrow-based security index. If some but not all of the securities or issuers thereof in an index are exempted securities, the index will be a narrow-based security index only if the index is narrow-based when those exempted securities are disregarded.

H. Security Indexes

A security index is generally designed to reflect the performance of a market or sector by reference to representative securities or interests in securities. Market participants sometimes, however, enter into a Title VII Derivative Instrument where the underlying reference of the Title VII Derivative Instrument is a portfolio of securities selected by the counterparties or created by a third-party index provider at the behest of one or both counterparties. Where either or both counterparties have, directly or indirectly, the discretionary authority to change the composition of the security portfolio or index, the security portfolio or index would be a narrow-based security index and any Title VII Derivative Instrument based on such index would be a security-based swap. If the index composition is determined prior to execution or changes only pursuant to predetermined criteria or a self-executing formula, the index would retain the narrow-based or broad-based character it had at execution. The predetermined or self-executing formula may not be subject to change throughout the life of the instrument and may not be influenced by the counterparties, their agents or a third-party index provider with discretionary authority to alter the index.

I. Indexes that Migrate Between Broad-Based and Narrow-Based

If the index underlying a Title VII Derivative Instrument migrates between being broad-based and narrow-based, this will not change the determination of the Title VII Derivative Instrument regardless of whether it was entered into bilaterally or executed through a trade on or subject to the rules of a designated contract market ("DCM"), swap execution facility ("SEF"), foreign board of trade, security-based SEF or national securities exchange. As discussed above, the character of a Title VII Derivative Instrument is determined by the parties prior to execution or not later than when the parties offer to enter into the Title VII Derivative Instrument.

If material terms of the Title VII Derivative Instrument are amended or modified through an exercise of discretion (i.e., not through predetermined criteria or a self-executing formula), the Commissions would view that as a new Title VII Derivative Instrument and the character of the underlying index must be re-assessed as of the time of the amendment or modification.

J. Settlement of Index CDS

The method of settlement of an index CDS may affect its characterization. An index CDS on a broad-based security index and including mandatory settlement provisions requiring the delivery of a non-exempted security or a loan would be a mixed swap. An index CDS on a broad-based security index including mandatory cash settlement is a swap, regardless of whether cash settlement is based on the value of a non-exempted security or loan. An index CDS that is not based on a narrow-based security index under the Commissions' rules and that provides for cash settlement in accordance with the 2009 ISDA Credit Derivatives Determinations Committees and Auction Settlement Supplement to the 2003 Definitions or with the 2009 ISDA Credit Derivatives Determinations Committees and Auction Settlement CDS Protocol is a swap, and will not be considered a security-based swap or a mixed swap solely because the determination of the cash price to be paid is established through a securities or loan auction.

4. MIXED SWAPS

A mixed swap is an instrument that is both a swap and a securities-based swap. The Commissions expect that this will be a narrow category of instruments. The Adopting Release makes clear that parties' use of certain market standard agreements will not, by itself, transform a Title VII Derivative Instrument into a mixed swap.

The Commissions recognize that dual regulation of mixed swaps may be duplicative and even conflicting, and have tried to limit the scope of their respective regulatory regimes while ensuring that there are no gaps in regulation. An uncleared bilateral swap with at least one counterparty that is registered as both a security-based swap dealer or a major security-based swap participant and a swap dealer or a MSP must comply with all applicable provisions of the federal securities laws and CEA requirements with respect to (i) examinations and information sharing, (ii) enforcement, (iii) reporting to a swap data repository ("SDR"), (iv) real-time reporting, (v) capital and (vi) position limits. All other mixed swaps generally must comply with both the CEA and the Exchange Act regulations relating to swaps and security-based swaps, unless one person requests and is granted a joint order (to be made public) permitting that person to comply with only one set of regulations where the CFTC and SEC regulations are parallel.

5. SECURITY-BASED SWAP AGREEMENTS

A security-based swap agreement ("SBSA") is defined as a "swap agreement" of which "a material term is based on the price, yield, value, or volatility of any security or any group or index of securities, including any interest therein." SBSAs are swaps. The CFTC has regulatory authority over SBSAs, while the SEC has anti-manipulation, anti-fraud and certain other authority.

The Commissions noted in the Final Release that swaps (including CDS) based on a broad-based security index and swaps based on U.S. Treasury securities or on certain other exempted securities other than municipal securities are SBSAs under the DFA. The Commissions declined to mandate books and records requirements for SBSAs in addition to those that apply to swaps. Thus, SDRs have the same requirements regarding the keeping and maintenance of books and records and the collection of maintenance of data for SBSAs that they do for swaps. Swap dealers, MSPs, security-based swap dealers and major security-based swap participants likewise have the same books and records requirements for swaps as they do for SBSAs.

6. PROCESS FOR REQUESTING INTERPRETATIONS OF CHARACTERIZATION OF TITLE VII DERIVATIVE INSTRUMENTS

Recognizing the inherent difficulty in determining whether a certain instrument is a swap, security-based swap or a mixed swap, the Commissions put in place a mechanism for receiving an official interpretation as to this status. The Commissions adopted the Proposed Rules without modification. The Final Rules provide that any person may submit a request for a public joint interpretation to the Commissions by providing the Commissions with:

- all material information regarding the terms of the instrument (or class of instruments);
- a statement of the economic characteristics and purpose of the instrument (or class of instruments);
- the requesting party's determination as to whether the instrument (or class of instruments) should be characterized as a swap, security-based swap or mixed swap; and
- such other information as may be requested by either Commission.

While the requesting person may withdraw the request, the Commissions may nevertheless issue an interpretation if they believe one to be necessary. The Commissions must issue an interpretation or explain the reasons for not issuing an interpretation within 120 days following the complete submittal of the request. In the alternative, the Commissions may issue a joint notice of proposed rulemaking within the 120-day period to further define the terms swap, security-based swap and/or mixed swap. In response to comments expressing concern with the public availability of information related to a request for interpretation, the Commissions noted in the Adopting Release that a requesting person may seek confidential treatment for a request in accordance with existing rules relating to confidentiality, but that the joint interpretation or the decision not to issue a joint interpretation will be made publicly available at the end of the review period.

7. ANTI-EVASION

In the Adopting Release, the CFTC issued guidelines arising out of the DFA's delegation of anti-evasion authority. The core anti-evasion regulation, Rule 1.3(xxx)(6), was adopted as proposed. Rule 1.3(xxx)(6)(i) states that "[a]n agreement, contract, or transaction that is willfully structured to evade any provision of Subtitle A of the [DFA], including any amendments made to the Commodity Exchange Act thereby . . . shall be deemed a swap for purposes of Subtitle A and the rules, regulations, and orders of the [CFTC] promulgated thereunder." The CFTC explained that a person acts "willfully" when acting either intentionally or with reckless disregard. The anti-evasion authority is granted only to the CFTC and not to the SEC.

Furthermore, Rule 1.3(xxx)(6)(ii) states that interest rate swaps and currency swaps that are willfully structured as foreign exchange swaps or foreign exchange forwards in order to evade the DFA regulatory regime will be deemed swaps. Rule 1.3(xxx)(6)(iii) applies to banks, and states that a bank's agreement, contract or transaction that is not under the jurisdiction of a federal banking agency and is willfully structured to evade the CEA will be deemed a swap.

Rule 1.3(xxx)(6)(v) states that any contract, agreement or transaction willfully structured to evade as provided in Rules 1.3(xxx)(6)(i) through 1.3(xxx)(6)(iii) will be considered in determining whether a person is a swap dealer or an MSP. Rule 1.3(xxx)(6)(vi) clarifies that securities and security-based swaps are outside the scope of the CFTC's anti-evasion authority, specifically stating that any contract structured as a security pursuant to the Exchange Act shall not be deemed a swap or considered in determining whether one is a swap dealer or an MSP.

Rule 1.6, which was adopted as proposed, states that it is unlawful to conduct activities outside the U.S. to willfully evade or attempt to evade any DFA provision, rule or regulation. As with Rule 1.3(xxx), Rule 1.6 contains provisions whereby the

CFTC will not consider the form, label or documentation of a transaction to be dispositive in its determination and whereby securities and security-based swaps shall not be deemed swaps.

While the CFTC intends to evaluate each activity on a case-by-case basis, in responding to comments to the Proposing Release, the CFTC affirmatively clarified that two types of transactions will not be considered evasive: (i) transactions that qualify for the forward exclusion from the definition of swap and (ii) transactions that have been self-certified by an SEF or a DCM or that received prior CFTC approval. In those situations where a transaction includes both a willful evader and an innocent party, the CFTC will only impose sanctions on the willful evader.

The CFTC intends to use two interpretive tests to gauge whether a transaction is evasive. The Business Purpose Test Interpretation involves the consideration of whether a purported evader has a "legitimate business purpose for structuring the instrument or entity or entering into the transaction in that particular manner." Accordingly, if a transaction is "structured in a manner solely motivated by a legitimate business purpose," the CFTC will not consider that transaction to be evasive. The mere fact that a person considers regulatory burdens and the avoidance thereof while structuring a transaction is not dispositive that the person lacks legitimate business purpose. The CFTC further explained that a transaction that has a legitimate business purpose could still be considered willfully evasive.

The Fraud, Deceit or Unlawful Activity Interpretation is derived from IRS decision-making on what constitutes tax evasion. Pursuant to this interpretation, the CFTC will consider the extent to which an activity constitutes deceit, deception or other illegitimate or unlawful activity.

V. RECORDKEEPING AND REPORTING REQUIREMENTS

1. Recordkeeping

Pursuant to CFTC Rule 45.2, which was finalized in January 2012, various swap participants are required to keep records of their swaps. End users are required to "keep full, complete and systematic records, together with all pertinent data and memoranda, with respect to each swap in which they are a counterparty," including records proving that their swaps are exempt from mandatory clearing under Section 2(h)(7) of the CEA. All participants must retain records through the life of the swap and for a period of five years after the swap is terminated. End-users may keep records in electronic or paper form, as long as the information is retrievable and reportable. Records kept by end users shall be retrievable within five business days, while records kept by other participants should be readily accessible via real-time electronic access throughout the life of the swap plus two years, and within three business days thereafter. Records must be open to inspection by the Department of Justice, the CFTC, the SEC and representatives of prudential regulators.

2. Reporting

For swaps executed on an SEF or a DCM, the SEF or DCM must report swap creation data, including confirmation data and primary economic terms, "as soon as technologically practicable" after the swap's execution. Furthermore, "as soon as technologically practicable" after clearing, the derivatives clearing organization ("DCO") must report all confirmation data for the swap to the SDR.

For swaps that are not executed on or pursuant to the rules of an SEF or a DCM ("off-facility swaps") but are subject to mandatory clearing, there are also reporting requirements for reporting counterparties. The identity of the reporting counterparty is determined as follows. If only one counterparty is a swap dealer, then the swap dealer is the reporting counterparty, but if neither counterparty is a swap dealer but only one counterparty is an MSP, then the MSP is the reporting counterparty. If neither counterparty is a swap dealer or an MSP but one counterparty is a financial entity as defined in Section 2(h)(7)(C) of the CEA, then the financial entity reports. If both counterparties have the same status, then they decide amongst themselves who will report. Notwithstanding these rules, if neither party is a swap dealer or an MSP and only one party is a U.S. person, then the U.S. person reports.

Thus, for off-facility swaps subject to mandatory clearing, reporting counterparties that are swap dealers or MSPs must report the swaps' primary economic terms "as soon as technologically practicable" following execution but no later than 30 minutes after execution during the first year of compliance (e.g. October 12, 2012 through October 11, 2013 for interest rate and credit asset swaps) and no later than 15 minutes after execution thereafter (e.g. beginning October 12, 2013 for interest rate and credit asset swaps). Reporting counterparties that are end-users must also report data "as soon as technologically practicable" after execution, but are given four business hours after execution during the first compliance year (i.e. April 10, 2013 through April 9, 2014 for all swaps), two business hours after execution during the second year of compliance (i.e. April 10, 2015 through April 9, 2016 for all swaps), and one business hour thereafter (beginning April 10, 2016 for all swaps). However, reporting to the SDR is not mandatory for any off-facility swap that is voluntarily submitted for clearing prior to the reporting deadline and is accepted for clearing before the reporting counterparty reports to the SDR. In this case, the reporting burden shifts to the DCO.

For off-facility swaps not accepted for clearing, swap dealers and MSPs must report confirmation data "as soon as technologically practicable" and within 30 minutes after confirmation if confirmation occurs electronically, or within 24 business hours if confirmation is not electronic. If the reporting party is an end user, then the confirmation data must be reported "as soon as technologically practicable" but no later than the end of the second business day after the confirmation date during the first compliance year (i.e. April 10, 2013 through April 9, 2014 for all swaps) and by the end of the first business day thereafter (i.e. beginning April 10, 2014).

For off-facility swaps not subject to mandatory clearing that have end users as the reporting counterparty, all primary economic terms are required to be reported "as soon as technologically practicable following execution" but no later than 48 business hours after execution during the first compliance year (i.e. April 10, 2013 through April 9, 2014 for all swaps), 36 business hours following execution during the second compliance year (i.e. April 10, 2014 through April 9, 2015 for all swaps) and within 24 business hours following execution during the third compliance year (i.e. beginning April 10, 2015 for all swaps). However, reporting to the SDR is not mandatory for any off-facility swap that is voluntarily submitted for clearing prior to the reporting deadline and is accepted for clearing before the reporting counterparty reports to the SDR. In this case, the reporting burden shifts to the DCO.

Required swap continuation data, including life cycle event data or state data and valuation data, must be reported pursuant to Rule 45.4. "State data" is the data necessary to provide a snapshot daily view of the economic terms of a swap. While DCOs, swap dealers and MSPs must report state data, along with valuation data, on a daily basis and life cycle event data on the day when the life cycle event occurs, end users are not required to report continuation data for cleared swaps. For uncleared swaps, end users must report life cycle event data no later than the second business day following the event during the first year of compliance (i.e. April 10, 2013 through April 9, 2014 for all swaps), and by the end of the first business day following the event thereafter (i.e. beginning April 10, 2014 for all swaps), or, in the alternative, they must report state data daily. For valuation data, end users must report the daily mark of the transaction as of the last day of each quarter within 30 days after the end of each quarter.

3. Pre-enactment Swaps and Transition Swaps - Recordkeeping

Part 46 of the CFTC regulations contains recordkeeping and reporting obligations for "pre-enactment swaps" and "transition swaps." Pursuant to Rule 46.1, "pre-enactment swaps" are those swaps that were entered into prior to July 21, 2010, when the DFA was enacted, that were not expired as of that date. A "transition swap" is a swap entered into on or after July 21, 2010 and before the appropriate compliance date, which varies by swap and counterparty and could fall between October 2012 and April 2013. According to Rule 46.2, each counterparty to a pre-enactment swap or a transition swap in existence on or after April 25, 2011 must keep records of primary economic terms listed in Appendix 1 to Part 46 as well as copies of master agreements, confirmations and credit support agreements, and modifications thereto, that it has in its possession on or after that date. If the pre-enactment swap or transition swap is in existence at the compliance date, then from that date on, each counterparty should keep all Part 45 documents.

If a pre-enactment swap expired prior to April 25, 2011 (i.e. a swap that was entered into prior to July 21, 2010, was unexpired as of July 21, 2010 and expired prior to April 25, 2011), each counterparty must maintain records about the terms of the transaction that it had possession of on or after October 14, 2010. The counterparty may choose to keep the records in the format they existed in on or after October 14, 2010, or in any other format.

If a transition swap expired prior to April 25, 2011 (i.e. a swap that was entered into on or after July 21, 2010 but expired prior to April 25, 2011), each counterparty must maintain records about the terms of the transaction that it had possession of on or after December 17, 2010, in the format in which the information existed on that day or in any other format.

Pursuant to Rule 46.2(c), records must be kept through the life of the swap and for a period at least five years after the swap's final termination. Records kept by a counterparty that is neither a swap dealer nor an MSP must be open to inspection by the DOJ, the CFTC, the SEC and representatives of prudential regulators and must be retrievable within five business days. The same rules largely apply to swap dealers and MSPSs, except that, for swaps in existence on or after April 25, 2011, they must also provide real-time electronic access to records through the life of the swap and for two years after the swap's final termination, and those records must be retrievable within three days throughout the mandatory recordkeeping period.

4. **Pre-enactment Swaps and Transition Swaps - Reporting**

The counterparties will need to determine which party will be required to report to the SDR. Pursuant to Rule 46.5, if only one counterparty is a swap dealer, then the swap dealer is the reporting counterparty. If only one counterparty is an MSP and neither party is a swap dealer, then the MSP reports. If neither counterparty is a swap dealer or an MSP but one counterparty is a financial entity as defined in Section 2(h)(7)(C) of the CEA, then the financial entity reports. Notwithstanding that, if neither counterparty is a swap dealer or an MSP but one counterparty is a U.S. person, then the U.S. person reports. If both counterparties have the same status, then they must decide amongst themselves as to who will be the reporting counterparty. It is the identity of the counterparties as of the compliance date (or, for expired or terminated swaps, as of the date of expiration or termination), rather than the date the swaps were entered into, that matters for the purposes of determining the reporting counterparty.

Prior to the compliance date, reporting counterparties for swaps in existence on or after April 25, 2011 must obtain a legal entity identifier. Non-reporting counterparties for such swaps must obtain a legal entity identifier within 180 days after the compliance date.

For swaps in existence on or after April 25, 2011, the reporting counterparty must report to the SDR by the compliance date the minimum primary economic terms, the legal entity identifier, the internal counterparty identifier and the internal transaction identifier used to identify the swap. The reporting party must report swap continuation data but only for those minimum economic terms listed in Appendix 1 to Part 46. For pre-enactment swaps expired or terminated prior to April 25, 2011, the reporting counterparty must only report information that was in its possession on or after October 14, 2010. For transition swaps expired or terminated prior to April 25, 2011, the reporting counterparty must only report information that was in its possession on or after December 17, 2010. Reporting is to the CFTC if no SDR is available for swaps in the asset class in question.

VI. CLEARING REQUIREMENT AND COMMERCIAL END-USER EXCEPTION

With respect to clearing, Section 2(h)(1)(A) of the CEA states that it "shall be unlawful for any person to engage in a swap unless that person submits such swap for clearing to a [DCO] that is registered under this [Act] or a [DCO] that is exempt from registration under this [Act] if the swap is required to be cleared." Section 2(h)(2)(B) of the CEA provides that a DCO shall submit to the CFTC each swap, or any group, category, type or class of swaps listed for clearing by the DCO, and the CFTC should review those submissions, provide for a public comment period and make a determination as to whether the swaps should be required to be cleared. Clearing a swap can have a significant impact on the trading of a swap as the DCO may have different collateral requirements, limit the type of swaps that can be cleared and affect the bilateral relationship between the swap counterparties.

In response, in Section 723(h)(7) of the DFA, Congress adopted an end-user exception from the clearing requirement. In July, the CFTC finalized the rule that enacts the end-user exception, Rule 39.6. Under the end-user exception as finalized in the rulemaking (the SEC issued a proposed rule in December 2010, but has yet to issue its final rule on the end-user exception), the clearing requirement shall not apply to a swap if one of the counterparties to the swap is:

(1) a nonfinancial entity;

(2) that is using the swap to hedge or mitigate commercial risk; and

(3) notifies the CFTC how it generally meets its financial obligations associated with non-cleared swaps.

1. Nonfinancial Entity

The exemption is often referred to as the commercial end-user exemption because it was meant to apply to nonfinancial entities. In general, a nonfinancial entity is any entity that falls outside the definition of financial entity in section 2(h)(7)(C)(i) of the CEA. That section defines a financial entity as a swap dealer, a security-based swap dealer, an MSP, a major security-based swap participant, a commodity pool, a private fund, certain types of benefit plans under ERISA, or a person predominantly engaged in activities that are in the business of banking or in activities that are financial in nature as defined in section 4(k) of the Bank Holding Company Act of 1956.[4] To be predominantly engaged in financial activities, the entity generally must either devote 85% or more of its assets to or derive 85% or more of its revenues from financial activities. The list of financial activities in section 4(k) is broad and includes activities such as insurance underwriting and agency, securities brokerage, investment advisory activities, and financial data processing.

The CFTC's final rule on the end-user exception also provides an exclusion from the definition of "financial entity" for small ($10 billion or less in total assets) depository institutions, credit unions and farm credit system institutions. Thus, these small financial institutions are also eligible for the commercial end-user exception.

2. Hedging or Mitigating Commercial Risk

While swaps that qualify as bona fide hedges under the CEA or qualify for hedging treatment under applicable Financial Accounting Standards Board guidance generally do qualify as hedging or mitigating commercial risk, the definition goes beyond such criteria and includes swaps that hedge or mitigate any of an entity's business risks, regardless of its accounting treatment. This provides a broader definition than was initially contemplated. The CFTC's rule states that a swap can be hedging or mitigating commercial risk if it is "economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, where the risks arise from" changes in values of assets and liabilities, including

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4 12 U.S.C. § 1843(k).

changes related to movements of interest rates and foreign exchange rates. In addition, swaps eligible for the end-user exception cannot be used for speculation, investing or trading.

3. Record-keeping and Reporting

An entity relying on the end-user exception is an "electing counterparty" for purposes of the reporting requirements. An electing counterparty may elect to report the required information on how it generally meets its financial obligations associated with non-cleared swaps annually in anticipation of electing an exemption from the clearing requirement for one or more swaps. Any such reporting would be effective for swaps entered into by the entity for 365 days following the date of such reporting. However, during that time the electing entity would be required to amend the information as necessary to reflect any material changes to the information reported. If an electing counterparty chooses not to report in advance of a swap transaction, Rule 39.6 requires one of the counterparties to a swap transaction with an electing counterparty, the "reporting counterparty,"[5] to report the required information.

A reporting counterparty in a swap transaction must provide, or cause to be provided to a registered SDR, or if no registered SDR is available, to the CFTC, the following information in the form and manner to be specified by the CFTC:

(i) Notice of the election of the exception;

(ii) The identity of the electing counterparty to the swap;

(iii) Whether the electing counterparty is a "financial entity" or exempt from the definition of a "financial entity"

(iv) Whether the swap or swaps for which the electing counterparty is electing the exception are being used to hedge or mitigate commercial risk, as defined in the regulation;

(v) How the electing counterparty generally meets its financial obligations associated with entering into non-cleared swaps by identifying one or more of the following categories, as applicable:

1. A written credit support agreement;
2. Pledged or segregated assets (including posting or receiving margin pursuant to a credit support agreement or otherwise);
3. A written third-party guarantee;
4. The electing counterparty's available financial resources; or
5. Means other than those described in 1 through 4 above; and

(vi) Whether the electing counterparty issues securities registered under section 12 of the Securities Exchange Act of 1934 ('34 Act) or is required to file reports under section 15(d) of the '34 Act, and if so

a. The relevant SEC Central Index Key number for the electing counterparty; and

[5] Rule 45.8 sets forth the criteria for determining which party to a swap transaction is the "reporting counterparty." In order of preference, the following parties to a transaction would be the reporting counterparty: a swap dealer, an MSP, and a financial entity. That section also sets forth the criteria for determining the reporting counterparty when more than one party to a transaction is one of the previously listed types of entities or none of the parties to a transaction is one of those types of entities. See Section IV (Recordkeeping and Reporting Requirements) for additional guidance.

b. Whether an appropriate committee of the electing counterparty's board of directors (or equivalent body) has reviewed and approved the decision to enter into swaps that are exempt from clearing.

4. Annual Reporting Option

An electing counterparty has the option of reporting most of the required information annually in anticipation of entering into swaps and electing the exemption or having the required information reported with each swap by one of the counterparties. Items (iii) through (vi) above may be reported in an annual filing, obviating the need for this information in the swap-by-swap reporting requirement. Any such annual reporting would be effective for swaps entered into by the electing entity for 365 days following the date of such reporting. However, during that time the electing entity would be required to amend the information as necessary to reflect any material changes to the information reported.

If an electing counterparty opts not to report in advance of a swap transaction, Rule 39.6(b) requires one of the counterparties to a swap transaction with an electing counterparty, the "reporting counterparty," to report the required information. The CFTC believes that in most instances, an electing counterparty will enter into a swap with a swap dealer, MSP or financial institution, and thus will not be the reporting counterparty. Nevertheless, the reporting counterparty will likely have to obtain the information from the electing counterparty unless the electing counterparty has filed an optional annual report.

VII. INTER-AFFILIATE EXCEPTION

On August 15, 2012 the CFTC proposed an additional exception for the clearing requirement for transactions between affiliates. This is a proposed rulemaking and is subject to a comment period that closes on September 20. Once the comment period closes, the CFTC may issue the proposed rule as a final rule, with or without modifications, or may determine that the proposed exception is not warranted or required.

The proposed inter-affiliate exception is available for transactions between majority-owned affiliates. Unlike the commercial end-user exception, it does not require that the transactions be entered into for the purpose of hedging or mitigating commercial risk. In addition, unlike the commercial end-user exception, the inter-affiliate exception is available even if the entities are financial entities, as well as swap dealers and MSPs. However, for these entities, variation margin must be collected, unless the affiliates are not financial entities.

A number of requirements apply to this exception. First, the trades must be documented with appropriate trading documentation. Second, there must be appropriate risk management internal processes, such as mark-to-market valuation. Third, like with the commercial end-user exception, the trades must be reported, and in the case of a ’34 Act filer, the use of this exception must be reviewed and approved by an appropriate committee of the company’s board.

An entity may rely upon the commercial end-user exception for certain trades and the inter-affiliate exception for other trades. It is not necessary to make a uniform exception across all trades.

VIII. CROSS-BORDER GUIDANCE

The CFTC recently issued proposed guidance ("Proposed Interpretive Guidance") related to the extraterritorial application of the DFA.[6] According to this Proposed Interpretive Guidance, the term U.S. person means, in relevant part:

> "(i) any natural person who is a resident of the United States; (ii) 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, in each case that is either (A) organized or incorporated under the laws of the United States or having its principal place of business in the United States . . . or (B) in which the direct or indirect owners thereof are responsible for the liabilities of such entity and one or more of such owners is a U.S. person . . . ."

Accordingly, entities that fall under the definition of "U.S. person" would have to comply with DFA exchange, clearing and reporting requirements even if they enter into contracts outside of the United States.

In the Proposed Interpretive Guidance, the CFTC stated that it is of the view that foreign branches or agencies of a U.S. person are covered by the DFA because they are "a part, or an extension, of a U.S. person." In contrast, foreign affiliates or subsidiaries of a U.S. person generally fall outside of the scope of the DFA, in the CFTC's view. However, the CFTC expressed its concerns with the affiliate structure where the U.S. person guarantees or provides similar support to the swap-related obligations of its affiliates and subsidiaries. Thus, the CFTC is considering whether the term "U.S. person" should be interpreted to include affiliates or subsidiaries guaranteed by the U.S. person.

In its Proposed Interpretive Guidance, the CFTC also noted as follows: "Given that a foreign branch or agency has no legal existence separate from a U.S. principal entity that is the legal counterparty to swaps, the [CFTC] would apply the [DFA] registration requirements to a U.S. person and its foreign branches and agencies on an entity-wide basis. Under this approach, the [CFTC] would require the U.S. person (principal entity) to register as the swap dealer. Although certain duties and obligations may be performed by the foreign branches and agencies, the U.S. person (principal entity) would remain responsible for compliance with all of the applicable responsibilities."

In its Proposed Interpretive Guidance, the CFTC indicated that it is also seeking comments as to whether the definition of "U.S. person" should include a concept of control "under which a non-U.S. person who is controlled by or under common control with a U.S. person would also be considered a U.S person."

The CFTC also indicated that in certain circumstances, foreign entities could be eligible for "substituted compliance." Pursuant to the Proposed Interpretive Guidance, those entities would be allowed to comply with their home regulations if the U.S. determines that the foreign regime is comparable to U.S. regulation. The CFTC noted that it "would make comparability determinations on an individual requirement basis, rather than the foreign regime as a whole," meaning that foreign entities could be eligible for substituted compliance for some DFA requirements but would need to comply with DFA for other obligations.

The comment period for the Proposed Interpretive Guidance closed on August 27, 2012. Below is a chart which sets forth the CFTC's proposed guidance for cross-border compliance with the following transaction-level requirements:

- Mandatory clearing
- Margin requirements
- Notifying counterparties of the right to have initial margin segregated

[6] "Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act," 77 Federal Register 134 (12 July 2012), pp. 41214-41242. http://www.cftc.gov/LawRegulation/DoddFrankAct/Dodd-FrankProposedRules/ssLINK/2012-16496a.

- Swap execution on an SEF or a DCM
- Relationship documentation
- Portfolio reconciliation and compression
- Real-time public reporting
- Trade confirmation
- Daily trading records

Cross-Border Application of DFA transaction-level requirements

Counterparty / Market participant	U.S. Person	Non-U.S. person guaranteed by U.S. person[7]	Non-U.S. person not guaranteed by U.S. person
U.S.-based swap dealer	DFA applies	DFA applies	DFA applies
Foreign affiliate of U.S. person (swaps booked in U.S.)	DFA applies	DFA applies	DFA applies
Foreign branch or agency of U.S.-based swap dealer	DFA applies	Potentially eligible for substituted compliance	Potentially eligible for substituted compliance
Foreign affiliate of U.S. person	DFA applies	Potentially eligible for substituted compliance	DFA does not apply
Non-U.S.-based swap dealer (swaps neither booked in U.S. nor guaranteed by U.S. person)	DFA applies	Potentially eligible for substituted compliance	DFA does not apply

[7] Pursuant to the Proposed Interpretive Guidance, in addition to non-U.S. counterparties that are guaranteed by U.S. persons, non-U.S. counterparties that meet the following test are also included in this column:

(a) the non-U.S. counterparty is majority-owned, directly or indirectly, by a U.S. person;
(b) the non-U.S. counterparty regularly enters into swaps with one or more other U.S. affiliates or subsidiaries of the U.S. person; and
(c) the financials of the non-U.S. counterparty are included in the consolidated financial statements of the U.S. person.

IX. KEY COMPLIANCE DATES

Below is a table which sets forth some key compliance dates by rule and counterparty.

	Registration	Spot-month limits and non-spot-month legacy limits	Real-time public reporting (Part 43) and swap data recordkeeping and reporting requirements (Part 45) - interest rate and credit asset classes	Real-time public reporting (Part 43) and swap data recordkeeping and reporting requirements (Part 45) of swap transaction data – foreign exchange, equity and “other commodity” asset classes	Real-time public reporting (Part 43) and swap data recordkeeping and reporting requirements (Part 45) – all swaps
Swap dealers and major swap participants	October 12, 2012	October 12, 2012	October 12, 2012	January 10, 2013	April 10, 2013
Swap execution facilities and designated contract markets	N/A	October 12, 2012	October 12, 2012	January 10, 2013	April 10, 2013
Non-SD and non-MSP counterparties	N/A	October 20, 2012	April 10, 2013	April 10, 2013	April 10, 2013

X. ISDA DODD-FRANK ACT PROTOCOL

On August 13, 2012, ISDA launched an initiative to allow swap dealers and MSPs to bring their existing over-the-counter swap relationships into compliance with certain provisions of the DFA that go into effect beginning on October 15, 2012. The initiative, known as the ISDA August 2012 Dodd-Frank (DF) Protocol (the "Protocol"), enables swap counterparties to adhere to a legal mechanism that amends existing documentation, including the ISDA Master Agreement, through the exchange of questionnaires and the subscription to a standardized set of agreements.

The Protocol is meant to address the information-exchange requirements of seven final rules that have been approved by the CFTC. Those rules pertain to business conduct standards for swap dealers and MSPs, large trader reporting for physical commodity swaps, position limits for future and swaps, real-time public reporting of swap transaction data and swap data recordkeeping. With regards to interest rate swaps and credit swaps, swap dealers and MSPs are required to comply with the substantive reporting, recordkeeping and position limits rules by October 12, 2012. The same compliance date applies to foreign exchange swaps and commodity swaps, except that the real-time public reporting and recordkeeping requirements for those swaps have a compliance date of January 10, 2013.

The business conduct standards, however, which pertain to the exchange of information and representations between swap dealers and MSPs and their counterparties, have a different compliance schedule. Some of the rules, such as Rule 23.431(d), which requires swap dealers and MSPs to notify counterparties about their right to receive a daily mark from the DCO, or for uncleared swaps, to provide the daily mark themselves, must be complied with by October 15, 2012. However, on August 27, 2012, the CFTC responded to ISDA's request to delay compliance dates and accordingly extended the compliance dates for other rules, including the safe harbor provisions described below, to January 1, 2013.

The Protocol allows swap dealers and MSPs to comply with relevant rules under the DFA by obtaining "know your counterparty" information and confirming that the counterparties are "eligible contract participants." Swap dealers and MSPs may enter into the Protocol with their counterparties even if their relationship is not governed by an ISDA Master Agreement. To participate in the Protocol, both parties must submit Adherence Letters agreeing to the terms of the Protocol Agreement, which is a document that establishes the process for amending existing agreements governing the terms of swap transactions. After parties sign the Adherence Letters, they will exchange Questionnaires to facilitate the delivery of required information to their counterparties. The Questionnaire contains representations as to the legal status of the counterparties, such as swap dealer, MSP and eligible contract participant, and allows the counterparty to make elections to the DF Supplement.

The DF Supplement is the document that amends the counterparties' existing agreement, containing various standardized representations, notifications and acknowledgments. The DF Supplement contains various "DF Schedules." While two of the schedules contain representations and are thus incorporated into the DF Supplement by the exchange of Questionnaires, four schedules are optional and only go into effect if both counterparties elect to apply them. The four supplemental schedules arise out of the "safe harbor" provisions contained in CFTC Rules 23.434 and 23.440. Pursuant to Rule 23.434(a), a swap dealer that recommends a swap or trading strategy involving a swap to a counterparty must follow certain practices, including undertaking "reasonable diligence to understand the potential risks and rewards" arising out of the recommendation" and having "a reasonable basis to believe that the recommended swap or trading strategy involving a swap is suitable for the counterparty." However, Rule 23.434(b) allows the swap dealer to fulfill these obligations if (1) it can reasonably determine that its counterparty "is capable of independently evaluating investment risks" in relation to the recommended product, (2) it "discloses in writing that it is acting in its capacity as a counterparty and is not undertaking to assess the suitability" of the offered product, and (3) the counterparty certifies that "it is exercising independent judgment in evaluating the recommendations." Rules 23.440 and 23.450 contain additional representations and apply only to "Special Entities," which term includes government agencies, endowments and employee benefit plans. The four supplemental schedules contain the determinations and representations necessary to comply with these "safe harbor" provisions.

While the Adherence Letters, the Protocol Agreement Questionnaires and the DF Supplement form the basic infrastructure of the DF Protocol, an additional document, known as the DF Terms Agreement, is an optional agreement that may be used by parties whose swap transactions are not governed by an ISDA Master Agreement or another written agreement and who wish to incorporate selected parts of the DF Supplement into their ongoing relationship.

The Protocol was launched on August 13, 2012. Starting September 10, 2012, parties will be able to complete their entire questionnaires and may begin exchanging their questionnaires via ISDA Amend, a special electronic mechanism for the information-gathering process.