

Regulatory brief

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Derivatives: A first take on cross-border comparability

Introduction

On Friday, December 20, 2013, the Commodity Futures Trading Commission ("CFTC") provided a first look at its swaps regulation "comparability" determinations – indicating which entity-level, and in some cases transaction-level, requirements in six jurisdictions¹ the Commission deemed "comparable" to its own rules, thus permitting non-US swap dealers ("SDs") major swap participants ("MSPs"), and the foreign branches of US SDs and MSPs in these jurisdictions to comply with local rules in lieu of Commission rules. While the headline was "CFTC makes comparability determinations," the reality is that the task is far from over.

The CFTC met its December 21st deadline by issuing a brief press release and an accompanying table summarizing their determinations – and related caveats – across the six jurisdictions. While providing some clarity around the CFTC's cross-border compliance expectations, the devil will once again be in the details that we expect will be found in the full text of the comparability determinations, and in how the CFTC will address the application of the requirements that were left out of Friday's release. Moreover, even taking the summary documents at face value, the comparability determinations are hardly a panacea and must be viewed in context. On transaction-level rules, in particular, the determinations present challenges, namely a lack of clear guidance on how those rules will be applied in practice, and what the CFTC expects in cases where they've neither made comparability determinations nor provided some form of no-action relief. Barring any last-minute reprieve from the Commission, impacted swap dealers should be prepared to immediately comply with those requirements where neither a comparability determination nor some type of time-limited relief was provided on Friday.

This **Financial Services Regulatory Brief** provides (a) an overview of the CFTC's comparability announcements for entity- and transaction level-requirements, and (b) our insight regarding what this may mean in the near term for both US and non-US swap dealers.

¹ Covered jurisdictions include Australia, Canada, the European Union, Hong Kong, Japan, and Switzerland.

Where we started

The CFTC's actions on Friday stemmed from the expiration of an exemptive order it issued in July 2013.² In its July *Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations* ("Cross-border Guidance"),³ the CFTC outlined its substituted compliance regime, indicating that where it determined that the law of a non-US SD's home jurisdiction is comparable to the CFTC's own requirements, then a non-US SD or MSP or foreign branch of a US SD would be able to comply with the local law to satisfy comparable CFTC requirements. At the time of the release of the Cross-border Guidance, SDs were provided temporary relief from application of some requirements – until December 21st or until 30 days after the issuance of a substituted compliance determination – through an exemptive order.⁴ The thought behind this exemptive order was that by the end of the year, regulators in foreign jurisdictions would have made enough progress with derivatives regulations to allow the CFTC to perform a comparative analysis.

Entity-level requirements for non-US swap dealers

The CFTC took its first cut at comparability determinations on the eve of the December 21st deadline for expiration of the exemptive order. The comparability findings are not comprehensive as to all entity-level requirements – they only address some internal business conduct-related requirements. Clearly this is the first step in what will be an on-going process.

Comparability determinations

The determinations affect non-US SDs located in six jurisdictions – Australia, Canada, the EU, Hong Kong, Japan and Switzerland. Generally, the release indicates that local regulations in the six jurisdictions covering the following entity-level requirements are comparable to the CFTC requirements, and SDs in those jurisdictions can rely on local rules, subject to several specific exceptions:

- Chief compliance officer ("CCO")
- Swap data recordkeeping

- Risk management
- Monitoring of position limits
- Diligent supervision
- Business continuity
- Research conflicts
- Clearing conflicts
- Undue influence
- Availability of information for disclosure
- Clearing member risk management⁵

The determinations released by the CFTC on Friday are little more than a summary chart. However, even the summary description comes with several caveats. For example, despite finding CCO requirements in all six jurisdictions "comparable" to its own requirements, the CFTC nonetheless indicates in a footnote that non-US SDs will still have to provide the CFTC with an annual CCO report, the accuracy of which is certified by the SD's CCO or chief executive officer. Similarly, the CFTC will still require non-US SDs to produce quarterly risk exposure reports to the CFTC despite the general comparability finding regarding risk management programs. The CFTC also reserves its right to require non-US SDs to provide direct access to certain books and records, despite finding that rules regarding access in all six jurisdictions are "comparable." The upshot here is that while the CFTC has found several entity-level business conduct rules to be broadly comparable to its own, the devil will once again be in the details on how the rules will be interpreted and applied.

No Action Letters

Simultaneous with the comparability determinations, CFTC staff issued two no-action letters that address a few of the questions raised by the determinations. The first letter concerns reporting obligations under the Commission's swap data reporting ("SDR") and historical swap reporting rules.⁶ Although defined as an entity-level requirement in the Cross-border Guidance, SDR rules were not included in the CFTC's summary comparability findings. The first no-action letter provides that Commission staff will not recommend enforcement action against a non-US SD or MSP located in Australia, Canada, the EU, Japan or Switzerland for

⁵ See Table A, within, for a description.

⁶ Time-Limited No-Action Relief from Certain Requirements of Part 45 and Part 46 of the Commission's Regulations, for Certain Swap Dealers and Major Swap Participants Established under the Laws of Australia, Canada, the European Union, Japan or Switzerland, CFTC Letter No. 13-75 (Dec. 20, 2013).

² See PwC's *Financial Services Regulatory Brief, Derivatives: CFTC finalizes cross border guidance and extends timeframe for conformance – July 12th deadline met* (July 2013).

³ 78 Fed. Reg. 45292 (July 26, 2013).

⁴ Exemptive Order Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 43785 (July 22, 2013).

failure to comply with certain reporting requirements, provided the SD is not part of an affiliated group in which the ultimate parent is a US SD or MSP, US bank, US financial holding or US bank holding company. The time-limited relief applies to:

- SDR requirements for swaps with non-US counterparties that **are not** guaranteed affiliates, or conduit affiliates, of a US person, until the earlier of (a) 30 days following the issuance of a comparability determination with respect to the SDR rules of the jurisdiction in which the non-US SD/MSP is established, or (b) December 1, 2014;
- SDR requirements for swaps with non-US counterparties that **are** guaranteed affiliates, or conduit affiliates, of a US person, until March 3, 2014; and
- Historical swap reporting rules for swaps with non-US counterparties that are guaranteed affiliates, or conduit affiliates, of a US person, until April 2, 2014.

The second no-action letter addresses some of the areas where the CFTC was unable to make comparability findings. More specifically, the CFTC notes that the Commission did not find rules in non-US jurisdictions comparable to the CFTC's quarterly risk exposure reporting requirements under CFTC Regulation 23.600(c)(2). Nor did the Commission make determinations with regard to rules governing restrictions on counterparty relationships, and clearing member risk management (CFTC Regulations 23.608 and 23.609, respectively). The staff no-action letter essentially softens the blow in these areas, providing that:

- Non-US swap dealers in Australia, Canada, the EU, Japan, and Switzerland have until March 3, 2014 to come into compliance with the requirements of CFTC Regulations 23.600(c)(2) and 23.608; and
- Non-US swap dealers in Switzerland have until March 3, 2014 to comply with CFTC Regulation 23.609.⁷

Notably absent from both no-action letters is reference to Hong Kong, as it appears that the CFTC has not made any determinations regarding these entity-level requirements under Hong Kong rules. Therefore, dealers with locations in Hong Kong should closely review the full text of the comparability determinations to determine what course of action they need to take with regard to these specific requirements.

⁷ See Table B for details.

Transaction-level rules

The CFTC also made a passing reference in its press release to comparability determinations for the EU and Japan for certain transaction-level requirements. Transaction-level rules present different challenges for non-US SDs and US SDs trading from non-US branches. Foreign branches of US swap dealers and non-US swap dealers must consider transaction-level rules for trades with foreign branches of US swap dealers and with non-US conduits or guaranteed affiliates.

The press release indicated that the CFTC will issue comparability decisions for the following transaction-level rules, and those decisions may be included in the Federal Register release:

Topic	EU	Japan
Confirmations	Comparable	TBD
Portfolio Reconciliations	Comparable	TBD
Portfolio Compression	Comparable	TBD
Swap Documentation	Certain provisions comparable	All except FDIC notice
Recordkeeping	Certain provisions comparable	Certain provisions comparable

The CFTC remained silent on comparability decisions for transaction-level requirements⁸ in Hong Kong, Switzerland, Australia, and Canada. While the industry had hoped the CFTC would push out the December 21st compliance date for transaction-level requirements due to the lack of a determination, the CFTC did not issue any

⁸ In its Final Guidance and accompanying Exemptive Order, the CFTC stated it would issue comparability determinations for each of the eight transaction-level requirements. However, the CFTC remained silent on the availability of substituted compliance for these requirements in its December 20, 2013 releases. Specifically, determinations were not made for the following requirements for the remaining jurisdictions: clearing and swap processing, margin and segregation for uncleared swaps, trade execution, portfolio compression and reconciliation, swap trading relationship documentation, real-time reporting, trade confirmations, and daily trading records.

time-limited relief for compliance with these requirements. Barring late-arriving relief from the CFTC, it therefore appears non-US SDs as well as foreign branches of US SDs located in those jurisdictions need to be in compliance with transaction-level requirements for transactions with foreign branches and guaranteed, or affiliate, conduits of US Persons as of December 23, 2013.

The upshot

The CFTC's comparability determinations provide a path forward on substituted compliance that still remains difficult to navigate. Non-US SDs will remain on the hook for CCO and periodic risk exposure reports, with 2014 deadlines to consider now. US SDs that have not implemented global Dodd-Frank solutions regarding

transaction-level requirements for foreign trades may now have to revisit their approach. While the time-limited no-action relief in the companion staff letter regarding reporting provides temporary relief, the timing and scope of eventual comparability determinations on reporting rules are still uncertain. Moreover, rules not yet finalized – such as capital requirements – will have to be addressed at some point in the future. Given that the CFTC appears determined to forge ahead with its substituted compliance program on a piecemeal basis, the devil will be in the details even more so than usual.

Table A: Summary of substituted compliance determinations

Entity-Level Requirements	CFTC Regulation Reference	Substituted Compliance Plan Status					
		EU	Japan	Switzerland	Australia	Hong Kong	Canada
Chief Compliance Officer	3.3	✓ (Notes 1,2)	✓ (Note 2)	✓ (Note 2)	✓ (Note 2)	✓ (Note 2)	✓ (Note 2)
Risk Management	23.600 (Note 4)	✓	✓	✓	✓	✓	✓
	23.601	✓	✓	✓	✓	✓	✓
	23.602	✓	✓	✓	✓	✓	✓
	23.603	✓	✓	✓	✓	✓	✓
	23.605(c)	✓	✓	✓	✓	✓	✓
	23.605(d)	✓	✓	✓	✓	✓	✓
	23.605(e)	✓	✓	✓	✓	✓	✓
	23.606	✓	✓	✓	✓	✓	✓
	23.608	Time Limited Relief until 3/3/14	Time Limited Relief until 3/3/14	Time Limited Relief until 3/3/14	Time Limited Relief until 3/3/14	O	Time Limited Relief until 3/3/14
	23.609	✓	✓	Time Limited Relief until 3/3/14	✓	O	✓
Swap Data Recordkeeping	23.201	✓ (Note 3)	✓ (Note 3)	✓ (Note 3)	✓ (Note 3)	✓ (Note 3)	✓ (Note 3)
	23.203	✓ (Note 3)	✓ (Note 3)	✓ (Note 3)	✓ (Note 3)	✓ (Note 3)	✓ (Note 3)
Swap Data Repository ("SDR")	Part 45	See separate chart in regards to relief for reporting					
	Part 46						

Legend:

✓	Substituted Compliance plan approved
X	Substituted Compliance plan denied
O	No Substituted Compliance determination made

Notes

- Note 1: CFTC Regulation 3.3(e) was excepted from the Commission's determination; thereby requiring non-US SDs/MSPs to submit an annual compliance report to the CFTC. An accompanying no-action letter provides time-limited relief to this requirement until March 3, 2014.
- Note 2: CFTC Regulation 3.3(f) was excepted from the Commission's determination; thereby requiring (i) the CEO or CCO of a swap dealer or MSP to certify that the annual compliance report is accurate and complete, and (ii) the annual compliance report to be furnished to the CFTC
- Note 3: The CFTC reserves the right to require a SD or MSP to provide direct access to or produce records required to be maintained under the CEA and CFTC regulations to CFTC staff, the staff of an applicable US prudential regulator, or the US Department of Justice
- Note 4: CFTC Regulation 23.600(c)(2) was excepted from the Commission's determination; thereby requiring non-US SDs/MSPs to submit periodic risk exposure reports to the CFTC. An accompanying no-action letter provides time-limited relief to this requirement until March 3, 2014.

Table B: SDR reporting relief

Parts 45 and 46 Compliance Dates for non-US SDs/MSPs located in the EU, Japan, Australia, Switzerland and Canada by Counterparty Type				
Entity-Level Requirements	CFTC Regulation Reference	Foreign Branch of US Bank that is a Swap Dealer or MSP	Non-US Person that is guaranteed by, or affiliate conduit of, a US Person	Non-US Person that is not guaranteed by, or affiliate conduit of, a US Person
Swap Data Repository ("SDR") Reporting	Part 45***	No relief	March 3, 2014	Earlier of: 30 days after substituted compliance determination is made or December 1, 2014
	Part 46***		April 2, 2014	

*** NAL relief does not apply to CFTC Regulations 45.2, 45.6, 46.2 and 46.4.

Additional information

For additional information about PwC's Financial Services Regulatory Practice and how we can help you, please contact:

Dan Ryan

Financial Services Regulatory Practice Chairman
646 471 8488
daniel.ryan@us.pwc.com

David Sapin

Financial Services Regulatory Practice Leader
646 471 8481
david.sapin@us.pwc.com

Armen Meyer

Director of Regulatory Strategy
646 531 4519
armen.meyer@us.pwc.com

Contributors: Margaret Paulsen, William Penner, and Melissa Slade.

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