FS Regulatory Brief

Certain foreign-owned US banks may avoid registration under swap dealer aggregation rule

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Certain US banks engaged in limited swap dealing activities were granted relief from swap dealer registration by the Commodity Futures Trading Commission (CFTC) on December 20, 2012.[1] Without this relief, these US banks were facing the prospect of either registering as a swap dealer, modifying their activities to fit into registration exemptions, or ceasing swap dealing all together. The relief permits these US banks to disregard the swap dealing activities of their registered foreign bank parent when determining whether they are under the CFTC's *de minimis* threshold for registration. In order to qualify for the relief, banks must meet a seven part test and file a claim for relief – relief is not automatic.

This **FS Regulatory Brief** provides a description of the aggregation rule and the relief provided to US banks with registered foreign bank parents.

The CFTC's aggregation rule requires an organization with multiple swap dealing affiliates to "aggregate" the non-exempt swap dealing transactions of all affiliates when calculating whether the organization exceeds the $8 billion total gross notional *de minimis* exemption from swap dealer registration.[2] Without this relief, this aggregation rule meant that foreign-owned US banks, whose foreign affiliates conduct substantial swaps activities and register as swap dealers, would have to register upon engaging in any non-exempt swap activities.

The conditions for exemption contained in the no-action relief are designed to ensure separate operations between the US bank and its foreign swap dealing affiliates. Essentially, the requirements are:

- The US bank must be a wholly owned national bank subsidiary of a foreign bank swap dealer,
- The US bank must have its own organizational, market and financial identity, and must have swap dealing operations that are separate from its foreign bank affiliate,
- The US bank may not rely on, or suggest that it relies on, the foreign bank to provide credit or other financial support for its swaps activities in the US market, and
- The foreign bank must be regulated as a financial holding company by the Federal Reserve, report financial statements to the Securities and Exchange Commission, and register as a swap dealer with the CFTC.

[1] The no-action letter is the latest in a series issued to address unintended consequences under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). *See* CFTC Letter No. 12-61, "No-Action Relief: US Bank Wholly Owned by Foreign Entity May Calculate De Minimis Threshold Without Including Activity From Its Foreign Affiliates" (December 20, 2012).

[2] The $8 billion *de minimis* exemption may be lowered to $3 billion annual total gross notional within five years. The *de minimis* exemption is $25 million with respect to trades with "Special Entities" (government agencies and pension funds generally).

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When the conditions are analyzed closely, this no-action relief appears to become narrow, and clarification from the CFTC might be helpful. For example, the relief does not exempt a US bank licensed under state, rather than federal, banking law. Also, the US bank's immediate parent must be a financial holding company, which is a particular status under federal banking law that may not be in place for certain foreign banks.

Most importantly, perhaps, it appears that the US bank must have separate operational systems for trading swaps in order to rely upon this relief. Therefore, systems integration with the parent bank could complicate the analysis of whether the US bank can obtain no-action relief. Potential applicants for this relief should carefully evaluate any shared service arrangements supporting their swaps activities.

Finally, a US bank must file notice of its intent to rely on this relief, and the notice must contain specific information. Given the looming year-end deadline for registration by many large foreign bank swap dealers, US banks wanting to take advantage of this relief should consider expeditiously filing their notices.

Summary of the Conditions for Relief from Aggregation Rule for Foreign-Owned US Banks

The CFTC's no-action relief allows a US bank that deals in swaps to *not* register as a swap dealer if all of the following conditions are met:

- The US bank is a national bank chartered by the Office of the Comptroller of the Currency and insured by the Federal Deposit Insurance Corporation
- The US bank is separately capitalized and is indirectly and wholly owned by a foreign bank parent
- The foreign bank parent is regulated by the Federal Reserve as a financial holding company, files financial statements with the Securities and Exchange Commission, is registered as a swap dealer with the CFTC, and is capitalized separately from the US bank
- The US bank does not exceed the *de minimis* threshold for swap dealing activities, as measured starting on October 12, 2012, without including dealing activities of any foreign affiliates or their US branches
- The US bank operates separately from the foreign bank with different identities, principal executives, administrative offices and financial statements
- The US bank trades swaps with clear financial separation from the foreign affiliates (i.e., no copies of financial statements of its foreign affiliates are provided to swap customers; there are no keep-well agreements or arrangements, guarantees, availability of foreign bank parent credit/assets; and no other suggestion exists that foreign affiliates are "undertaking any specific financial responsibility in connection with swaps activities")
- The US bank and its foreign affiliates serve different aspects of the US swap market (although the customers may be the same)
- The US bank does not rely on its foreign affiliates for operational servicing of its swaps business, and has separate core operational capabilities appropriate to the scope of its swap business (including separate credit determinations, except for broader enterprise risk management and foreign regulatory requirements)
- The US bank complies with Section 23B(c) of the Federal Reserve Act,[3] markets itself as a separate legal entity, and uses its name for swap trading, documentation and disclosures
- The US bank files a claim of no-action relief with the CFTC that contains specific information

[3] Section 23B provides that "[a] member bank or any subsidiary or affiliate of a member bank shall not publish any advertisement or enter into any agreement stating or suggesting that the bank shall in any way be responsible for the obligations of its affiliates."

Additional information

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