

No-action Guidance on SD, MSP and CPO Rules under Dodd-Frank Issued by CFTC

USA (National/Federal)

Related Content

On October 12, 2012, the CFTC issued several interpretive and no-action letters relating to threshold calculations for swap dealers (SDs), major swap participants (MSPs) and commodity pool operators (CPOs), as well as other matters relating to SDs, MSPs and CPOs, as the effective date for many regulatory obligations under Title VII of the Dodd-Frank Act arrived.

On October 12, 2012, the CFTC issued several interpretive and no-action letters concerning, among other things, the calculation of [notional](#), non-exempt swap activity for the purposes of determining whether a party must register as a swap dealer (SD), major swap participant (MSP), commodity pool operator (CPO) or commodity trading advisor (CTA) under final Dodd-Frank rules. The CFTC released these letters on the effective date for the CFTC's definitional rules, which triggered the obligation to begin tallying this activity for purposes of making these determinations under Title VII of the Dodd-Frank Act (see [Legal Update, October 12, 2012: Certain Dodd-Frank Swaps Rules Become Effective](#)).

The CFTC published the following letters:

- **Calculation of notional swap activity by foreign entities for purposes of SD/MSP designation.** The CFTC issued [No-action Letter 12-22](#) (No-action 12-22) addressing the calculation by certain foreign entities of their gross notional outstanding swap amounts for purposes of determining whether they are required to register as SDs or MSPs under Title VII. No-action 12-22 states that the CFTC will not take enforcement action against foreign entities for failure to include in the foreign entity's calculations required under the SD and MSP definitions any swap executed before the earlier of:
 - December 31, 2012; or
 - the effective date of a final definition of "US person" in a final exemptive order.

This safe harbor applies if the counterparty to the swap is not any of the following:

- a natural person who is a resident of the US;
- a corporation, partnership, LLC, business or trust, association, joint-stock company or fund (Legal Entities) that is organized or incorporated under the law of the US;
- a pension plan for the employees, officers or principals of a Legal Entity, unless it is exclusively for foreign employees of a Legal Entity;
- an estate or trust whose income is subject to US income tax; or
- an individual account (either discretionary or not) where the beneficial owner is a person described above.

For more detail on the extraterritorial application of Dodd-Frank swaps rules, see [Practice Note, The Dodd-Frank Act: Cross-border Application of Swaps Rules](#). For more information on SD and MSP thresholds and exempt swap activity, see [Practice Note, Is Your Client a Swap Dealer or Major Swap Participant? Breakdown of Final Dodd-Frank Definitional Rulemaking](#).

- **Conditional exclusion of FX swaps from SD, MSP, CPO and CTA calculations.** The CFTC issued a [No-action Letter 12-21](#) permitting parties to exclude their foreign exchange swaps and foreign exchange forwards when determining if they must register as an SD, MSP, CPO or CTA, provided the Secretary of the Treasury issues a final exemption for those transactions from the definition of "swap" under the Commodity Exchange Act (CEA) that is effective by December 31, 2012 (see [Legal Update, US Treasury Proposes Exemptions for Foreign Exchange Swaps and Forwards under Dodd-Frank](#)).

Update: On November 20, 2012, the Secretary of the Treasury did in fact issue a [final determination](#) exempting those transactions from the definition of "swap" under the CEA.

- **Exclusion of "excluded" and agricultural commodities from SD/SMP calculations.** The CFTC issued [No-action Letter 12-20](#), stating that it will not recommend enforcement action against any person who excludes from its calculation:
 - of its aggregate gross notional amount of non-exempt swaps for purposes of determining whether it is an SD (see [Practice Note, Is Your Client a Swap Dealer or Major Swap Participant? Breakdown of Final Dodd-Frank Definitional Rulemaking](#)) any swap executed prior to October 20, 2012 that references an agricultural commodity or an "excluded" commodity, such as energy commodities or metals; or
 - of daily average aggregate uncollateralized outward swap exposure or daily average aggregate potential outward exposure for purposes of determining whether it is an MSP (see [Practice Note, Is Your Client a Swap Dealer or Major Swap Participant? Breakdown of Final Dodd-Frank Definitional Rulemaking](#)) any outward exposures arising from any swap entered into through and including October 20, 2012 that references an agricultural commodity or an excluded commodity, such as energy commodities or metals.

See footnotes 1 and 2 of No-action 12-20 for details on what constitutes an "agricultural commodity" and what constitutes an "excluded commodity" for purposes of this exclusion.

- **Threshold for swaps with public utilities.** The CFTC issued [No-action Letter 12-18](#) allowing non-financial entities that are active in the physical energy markets to deal in swaps with publicly owned, government-owned or federal agency utilities in an aggregate gross notional amount of up to \$800 million per year without being required to register as an SD. Public utilities are classified as "special entities" under the final Dodd-Frank external business conduct (EBC) rules for SDs and MSPs (see [Practice Note, Swap Dealers and MSPs: Final Dodd-Frank External Business Conduct \(EBC\) Rules: Swaps with Special Entities](#) and [Legal Update, Final External Business Conduct Rules for Swap Dealers and Major Swap Participants under Dodd-Frank Issued by CFTC](#))).

To take advantage of this no-action relief and to avoid applying to be registered as an SD, a person must provide notice to the CFTC's Division of Swap Dealer and Intermediary Oversight stating that it is applying for this relief. SDs and MSPs that enter into swaps with special entities (which are ERISA plans and government entities, including public utilities) are subject to special rules under the final EBC rules. Under the final EBC rules, any entity that enters into \$25 million in swaps with special entities must register as an SD under Title VII (see [Practice Note, Swap Dealers and MSPs: Final Dodd-Frank External Business Conduct \(EBC\) Rules: Swaps with Special Entities](#)). However, because market participants have provided comment to the CFTC suggesting that they would be less inclined to enter into swaps with public utilities as a result of these rules, the CFTC has issued this relief.

- **Eligible contract participants.** The CFTC issued [No-action Letter 12-17](#) providing interpretive guidance stating that:
 - swap guarantors must generally be [eligible contract participants](#) (ECPs);
 - non-ECPs may not generally be jointly and severally liable for swap obligations; and
 - cash proceeds from a loan may be included in the calculation of total assets for purposes of qualifying as an ECP under the CEA.

In the same letter, the CFTC also issued corollary no-action relief under which the CFTC:

- would, until March 31, 2013, not require that swap guarantors generally be ECPs; and
 - would, until December 31, 2012, allow persons to rely on the pre-Dodd-Frank ECP definition or the second amendment to the CFTC's [final order](#) on swap regulation.
- **Associated persons (APs).** The CFTC issued interpretive guidance in [No-action Letter 12-15](#) permitting SDs and MSPs to employ an associated person (AP), even if that person is statutorily disqualified from serving as an AP, provided the SD or MSP consults with the National Futures Association (NFA). APs are natural persons who are associated with an SD, MSP or other CFTC registrant as a partner, officer, employee or agent (or any natural person with a similar status or function) in a capacity that involves the solicitation or acceptance of swaps (other than in a clerical or ministerial capacity). For information on final Dodd-Frank rules on associated persons, see [Legal Update, Final Rules on Associated Persons of Swap Dealers and MSPs Issued by CFTC](#).

- **Deadline extension for CPO/CTA registration and temporary exemption for certain vehicles.** On October 11, 2012, the CFTC issued [No-action Letter 12-15](#) extending until December 31, 2012 the deadline for registration under the Dodd-Frank Act as a commodity pool operator (CPO) or commodity trading advisor (CTA) by any entity that would have been required to register solely by virtue of its swaps activity. This extension is designed to address securitization vehicles specifically, though may capture other types of entities as well. In a [letter](#) to the American Securitization Forum (ASF) and SIFMA, the CFTC also granted permanent relief to securitization vehicles that meet certain criteria described in its letter from the definition of "commodity pool," which therefore means its "operator" need not register as a CPO. For more detail on this, see [Legal Update, Dodd-Frank CPO Registration Delayed for ABS Issuers](#).
- **CPO bona fide hedging clarification for registered investment companies.** The CFTC issued a [No-action Letter 12-19](#), stating that it will not commence an enforcement action against any operator of an investment company registered under the Investment Company Act of 1940 that excludes from its CPO-threshold calculations any transaction that satisfies the definition of "bona fide hedging," as defined in the CFTC's Regulations, as amended, even though this definition was amended by the vacated final CFTC position limits rules (see [Legal Update, CFTC Commodity Position Limits Rules Vacated by DC District Court](#)). However, it is the CFTC's position that this amendment was not addressed by the district court when it invalidated the final position limits rules, and therefore remains effective.

Under the final Dodd-Frank CPO rules, a registered investment company must register with the CFTC as a CPO if:

- its aggregate [initial margin](#) collateralizing transactions that are not bona fide hedges is equal to or greater than 5% of the liquidation value of the pool's portfolio; or
- its notional exposure under transactions that are not bona fide hedges is equal to or greater than 100% of the liquidation value of the pool's portfolio.

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