



JONES DAY
COMMENTARY

POTENTIAL IMPACT OF THE U.S. DODD-FRANK ACT AND GLOBAL OTC DERIVATIVES REGULATIONS

In connection with any over-the-counter (“OTC”) derivatives transactions you execute with U.S. entities and certain entities registered as “swap dealers” or “major swap participants,” you may need to determine the potential impact of U.S. OTC derivatives regulation on your business and trading activities. The U.S. Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) is part of a global effort to meet commitments of the Group of Twenty Finance Ministers and Central Bank Governors (“G-20”) on OTC derivatives regulation. It is important to review the potential impact of U.S. regulations under Dodd-Frank on your OTC derivatives transactions and how they may interact with OTC derivatives regulation being developed in your home jurisdiction and elsewhere in the world.

Specifically with respect to the U.S., the reach of Dodd-Frank on your activities will depend on the extent to which you enter into swaps with U.S. persons—keeping in mind that the term “U.S. person” has not been finalized by U.S. regulators. If you

enter into swaps with these counterparties, along with certain entities registered as swap dealers or major swap participants, you may be subject to certain Dodd-Frank provisions with respect to registration and/or transaction requirements. In addition, you should note that the regulation of OTC derivatives transactions in the U.S. is split among multiple regulatory bodies including the Commodity Futures Trading Commission (“CFTC”) and the Securities and Exchange Commission (“SEC”). The following discussion describes in broad terms the potential impact on your company of planned OTC derivatives regulation under the G-20 commitments and Dodd-Frank.

SWAPS

Dodd-Frank regulates swap transactions and, to various degrees, the parties who enter into swap transactions. What is and is not a swap is a very complicated question. Dodd-Frank and U.S. regulators define “swaps” broadly so as to capture an extensive

array of OTC derivatives transactions. In certain cases, such as, for example, interest rate swaps, it is a relatively straightforward analysis to determine that such a transaction falls within the definition of “swap” and is thus subject to Dodd-Frank. In other cases, such as forward transactions, determining whether that transaction is a swap or is a type of OTC derivatives transaction outside of the reach of Dodd-Frank may require complex analysis of the terms of the transaction and the facts and circumstances surrounding the execution of the transaction.

REGISTRATION

Dodd-Frank governs certain participants in swaps markets. If you engage in significant swap transactions, you yourself might be subject to registration as a swap dealer or major swap participant. Determining whether or not your swap activity is significant enough to require registration requires both a quantitative analysis as well as a facts and circumstances analysis. Swap participants are required to register with the applicable U.S. regulator if they exceed certain thresholds in connection with their swap transactions with U.S. persons. A key challenge is to determine which swap transactions should be included and excluded from these thresholds and how these thresholds should be calculated. Those not presently subject to registration may nevertheless need to carefully monitor their swap activities if they have significant aggregate swap positions either to determine when and if they (or their affiliates) would need to register in the future or to take appropriate steps to avoid the registration requirements.

If required to register, you may become obligated to satisfy extensive regulatory obligations on the conduct of your business and financial requirements. You would also be subject to margin and capital requirements with respect to your swap positions.

CLEARED AND UNCLEARED SWAPS

Historically, most swaps were privately negotiated transactions entered into between parties on a bilateral basis. Dodd-Frank, consistent with efforts of other G-20 countries, imposes a mandatory clearing requirement on many

swap transactions. As a result, going forward, many of your swaps may be required to be cleared through clearing houses. Under Dodd-Frank, swap transactions with standardized terms and high levels of liquidity are subject to mandatory clearing.

The CFTC recently finalized rules requiring mandatory clearing of certain interest rate swaps and credit swaps. These requirements will phase in during 2013 depending on the type of entity entering into these swaps that are subject to mandatory clearing. As required under Dodd-Frank, going forward the CFTC will from time to time propose other categories of swaps that will be subject to mandatory clearing.

Exceptions to the clearing requirement are available to certain market participants, in which case you may need to take steps to ensure that you can take advantage of these exceptions if it is economically beneficial to do so. Nonfinancial entities that are using swaps to hedge or mitigate commercial risk may be eligible to elect the “end user clearing exception” if they meet certain requirements and follow certain procedures. This exception allows parties satisfying the end user exception to continue to enter into swaps on a bilateral basis as they have done in the past. The clearing requirements for “end users” with respect to interest rate and credit swaps identified by the CFTC will become effective in the third quarter of 2013 unless the end user has previously taken the necessary steps to take advantage of the end user exception.

Generally, financial institutions, investment vehicles, and asset managers would not be able to take advantage of this exception. If you are not eligible for the clearing exception, in order to continue to enter into those swaps that are subject to mandatory clearing, you must enter into new documentation for cleared swaps. Clearing documents can be very complicated and may take a significant amount of time to negotiate, so it may be advisable to commence this process as soon as possible.

Cleared swaps are subject to margin (collateral) requirements imposed by both clearing houses and the clearing members through which cleared swaps must be traded. Uncleared swaps may also be subject to margin requirements, although at present, the rules governing the amount

of margin for uncleared swaps have not been finalized. Further, the dealers with whom you enter into uncleared swaps are expected to be subject to additional capital requirements for those swaps. Therefore, even those swap participants who can take advantage of the end user exception may want to keep open their option to clear some of their swap transactions, even if those transactions are otherwise eligible to be entered into on an uncleared basis. It is possible that the cost of entering into certain uncleared swaps, after taking into account capital and margin requirements (and other costs associated with potentially less liquidity), may actually be greater than the cost of entering into a comparable cleared swap. Accordingly, even if you have the right to enter into uncleared swaps, you should nevertheless consider entering into new documentation for cleared swaps.

Overall, the establishment of a clearing requirement for an OTC derivatives market that was previously unregulated may result in the need to reevaluate the relative costs of entering into cleared swaps, uncleared swaps, and futures contracts and any associated new regulatory requirements. Regulators in various jurisdictions will determine which categories of OTC derivatives transactions will be subject to mandatory clearing requirements and exceptions to the mandatory clearing requirements, as well as the costs imposed on cleared and uncleared transactions. G-20 regulators have agreed in principle to harmonize their regulations to the extent appropriate. Nevertheless, there are likely to be differences among jurisdictions as to which swaps must be cleared and the relative costs of entering into cleared versus uncleared swaps. Therefore, you may want to weigh the relative merits of transacting in these different jurisdictions and shift, where appropriate and lawful, your swap trading activities to jurisdictions where the costs and regulatory burdens of trading certain swaps are more beneficial.

EXCHANGES AND ELECTRONIC PLATFORMS

The G-20 has proposed that standardized OTC derivatives transactions trade on exchanges or electronic platforms where appropriate. Key features of these exchanges and electronic platforms include standardization of products, pre- and post-trade transparency, automated post-execution

processes, and market surveillance. The forms of these exchanges and electronic platforms may vary significantly from one jurisdiction to another, and they could include venues that trade on a fully multilateral basis using well-defined rules about how multiple orders interact, venues that facilitate bilateral transactions with limited restrictions on what can be traded and how the transactions are executed, and venues that blend elements of multilateral and bilateral trading mechanisms. You may need to evaluate trading strategies with respect to these venues and the products offered on different platforms (and if those products are subject to mandatory clearing requirements) and related costs.

Under Dodd-Frank, all swaps subject to mandatory clearing will eventually be required to be traded on “swap execution facilities,” but the rules governing these facilities and the final form they will take have not been finalized.

EXTRATERRITORIALITY

The extent to which the various rules and regulations of Dodd-Frank apply to the swap activities of non-U.S. persons or to swap transactions entered into outside of the United States is a very complicated and controversial issue. As proposed, many Dodd-Frank requirements extend well beyond the shores of the U.S. Even for non-U.S. persons who enter into swaps outside of the United States, determining the extent to which those swaps may be subject to at least some of the Dodd-Frank requirements can be a complicated task. Many of the relevant regulations are also not final, such as rules addressing the regulatory treatment of non-U.S. persons registered as swap dealers or major swap participants, which adds to the complexity. The extraterritorial reach of new financial regulations, however, is not an issue unique to Dodd-Frank. Many of the new financial reforms currently contemplated by the EU also extend well beyond the shores of the European Union.

The CFTC and the SEC are working with their counterparts in other jurisdictions to reach consensus to minimize conflicting regulatory requirements as well as regulatory gaps. A stated goal of the G-20 is to avoid, to the extent possible, the application of conflicting rules to the same entities and same transactions. Despite these efforts of regulators,

as noted above, you may still find yourself navigating inconsistent treatment due to various jurisdictions' differences in laws, policies, markets, implementation timing, and legislative and regulatory processes.

REPORTING

You or your counterparties may be required to report the swaps you enter into to trade repositories. By collecting, storing, and disseminating data on swap transactions, these trade repositories will provide transparency to regulators to monitor risks in the market and act as a source of information to market participants and the public. You may need to coordinate various reporting requirements and exclusions for swap transactions in different jurisdictions. The choices for compliance may also differ depending on the type of transaction, the counterparty to the transaction, and the manner in which the transaction is executed. Compliance with reporting requirements may affect your information technology systems, trading desk and back office operations, risk and compliance functions, and existing policies and procedures. In certain circumstances, modifications to your information technology systems may be extensive and require significant lead time. Recordkeeping requirements may equally apply to the swap transactions that are covered by these reporting requirements.

Generally, the rules under Dodd-Frank require that, where one of the parties to a swap transaction is a registered swap dealer or major swap participant, the reporting obligation falls upon the registered entity. In circumstances where neither party to a swap is a registered entity, if at least one party to the transaction is a U.S. person, it is the designated reporting party. In other words, if you are transacting swaps through entities that are non-U.S. persons (assuming you are not a registered entity), then you should not be required to report transactions under Dodd-Frank. However, depending on the pending final definition of "U.S. person," your subsidiaries and other affiliates may constitute U.S. persons for purposes of reporting requirements. The procedures for reporting transactions under CFTC final reporting rules and SEC proposed reporting rules are different.

DOCUMENTATION/POLICIES/PROCEDURES

Even for swaps not subject to mandatory clearing, the documentation governing those swaps must be amended to address the Dodd-Frank regulatory requirements being imposed on designated market participants. In circumstances where your swap counterparties are certain registered swap dealers or major swap participants, you may need to amend or execute new trading documentation to address those regulatory requirements. Your risk management and compliance functions may also need to adopt or update policies and procedures, which should account for the OTC regulations in each of the jurisdictions in which your company is transacting.

The International Swaps and Derivatives Association has issued and will issue in the future various protocols for amending bilateral swap documentation to address changes under Dodd-Frank. Some market participants are adopting these protocols with no alterations, while other market participants are adopting these protocols subject to certain modifications.

NEXT STEPS

To assess the potential impact of global OTC regulations and Dodd-Frank you should review your OTC derivatives transactions and the identity and regulatory status of your counterparties to determine your exposure to various requirements. This analysis will be complicated by the lack of complete rules and the ambiguities arising under newly issued rules that have not been tested in the market. Cross-border harmonization of global OTC regulations is still a work-in-progress, and while the intent expressed by the G-20 is to allow parties to choose to comply with one set of rules in situations where the rules of two jurisdictions apply and are consistent with each other, the details for implementation have not been resolved. To address these and other challenges, various swap participants are phasing in compliance with Dodd-Frank based on final regulations while maintaining flexibility to adopt different approaches depending on how the remaining regulations under Dodd-Frank and

the other global OTC derivatives regulations evolve. Based on the analysis of your OTC derivatives transactions, your exposure to Dodd-Frank and global OTC regulations may be minimal or it may be extensive, but in either case this review will enable you to assess their potential impact so that you can plan on prudent next steps.

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