

## financial regulatory reform lawflash

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## US Regulation of European OTC Derivatives

*OTC derivatives activity outside of the United States may be subject to US law.*

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act) will regulate most over-the-counter (OTC) derivatives, with much of the regulation currently set to become effective on 12 October 2012. The Act will require the central clearing and exchange-style trading of many OTC derivatives and will impose capital, margin, registration, reporting, recordkeeping, and business conduct requirements on certain market participants. There is considerable overlap with the proposed EU regulation of OTC derivatives (including the European Market Infrastructure Regulation (EMIR)).

The US Commodity Futures Trading Commission (CFTC) has recently issued proposed guidance on the extraterritorial application of regulations under the Act. The Securities and Exchange Commission (SEC) has not yet released guidance on this topic.

Under the proposed CFTC guidance (which is not final and may change), the CFTC regulations under the Act would generally apply to OTC derivatives where the counterparty is, or is guaranteed by, a "US Person". In this context, a US Person includes the following:

- Natural persons who are residents of the United States
- Legal entities organised under US law or having a principal place of business within the United States or entities in which the owners are responsible for the liabilities of the entity and one of the owners is a US Person
- Any individual account where the beneficial owner is a US Person
- Any commodity pool, pooled account, or collective investment vehicle of which a majority ownership is held by a US Person
- Any commodity pool, pooled account, or collective investment vehicle, the operator of which would be required to register as a commodity pool operator under the US Commodity Exchange Act
- A pension plan for the employees, officers, or principals of a legal entity with its principal place of business inside the United States
- An estate or trust, the income of which is subject to US income tax

The definition of US Person includes foreign branches or agencies of US Persons. However, a foreign affiliate or subsidiary of a US Person that is a separate legal entity is considered a non-US Person (even if guaranteed by a US Person).

The proposed guidance is quite nuanced and different regulatory outcomes may apply depending upon whether a party is (i) a US Person, (ii) a non-US Person guaranteed by a US Person, (iii) a non-US Person not guaranteed by a US Person, (iv) a US-based swap dealer, (v) a foreign affiliate of a US-based swap dealer that books swaps in the United States, (vi) a foreign branch of a US-based swap dealer, (vii) a foreign affiliate of a US Person where swaps are guaranteed by a US Person, (viii) a foreign affiliate of a US Person where swaps are not guaranteed by a US Person, or (ix) a non-US-based swap dealer where swaps are neither booked in the United States nor guaranteed by a US Person.

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In some of these instances, the CFTC rules will apply; in other instances, compliance with foreign laws may be an acceptable alternative to compliance with CFTC rules; and, in still other instances, no regulation will be imposed by CFTC rules. US counsel should be consulted to ascertain the potential application of the Act to each individual situation.

In summary, trading OTC derivatives in Europe is subject to increased risk of overlapping (and sometimes contradictory) regulation from the US and the EU. Caution should be exercised when the counterparty is a US Person.

## Contacts

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