U.S. Treasury Secretary Exempts FX Swaps and FX Forwards From Key Dodd-Frank Requirements

November 19, 2012

On Friday, November 16, 2012, U.S. Treasury Secretary Timothy Geithner issued the final determination to exempt foreign exchange (FX) swaps and FX forwards from regulation as "swaps." As a result, such instruments are exempt from several key Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) requirements for over-the-counter (OTC) derivatives, including mandatory clearing, electronic trade execution and margin requirements.[1]

The Treasury Secretary issued his final determination pursuant to authority granted by Section 1a(47)(E) of the Commodity Exchange Act (CEA), as amended by the Dodd-Frank Act. Section 1a(47)(E) provides that the Treasury Secretary may exclude FX swaps and FX forwards from regulation as swaps if he determinates that such instruments (1) should not be regulated as swaps under the CEA and (2) are not structured to evade the Dodd-Frank Act or any rules promulgated by the Commodity Futures Trading Commission (CFTC) thereunder. The Treasury Secretary cited the short-term nature of FX swaps and FX forwards, the fact that FX swaps and FX forwards have fixed payment obligations, and the fact that FX swaps and FX forwards are settled by the exchange of actual currency as factors that led to his issuance of the final determination.

As a result of the final determination, counterparties to FX swaps and FX forwards will not be required to comply with the myriad of requirements imposed on OTC derivatives by the Dodd-Frank Act including, among others, central clearing, electronic trade execution and margin requirements for uncleared trades. In addition, such transactions will not need to be included in swap dealer or major swap participant determinations. However, pursuant to the CEA, FX swaps and FX forwards will still be subject to the CFTC's reporting requirements and, to the extent that a swap dealer or major swap participant counterparty is involved, business conduct standards. Moreover, FX swaps and FX forwards will remain subject to the CEA's anti-manipulation provisions and the CFTC rules promulgated thereunder.

Since the final determination only applies to FX swaps and FX forwards, as those terms are defined in the CEA,[2] other types of derivatives related to or involving FX, including non-deliverable forwards, currency options and currency swaps, are considered swaps under the CEA and CFTC regulations. As such, market participants engaging in such transactions must comply with all Dodd-Frank Act requirements applicable to swaps.

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If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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[1] Margin requirements have been proposed by federal banking regulations, the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) but have not been finalized. The CFTC has not yet proposed to subject any derivatives related to or involving FX to clearing.

[2] An FX swap is defined in the CEA as a transaction that solely involves (1) an exchange of two different currencies on a specific date at a fixed rate that is agreed upon on the inception of the contract covering the exchange and (2) a reverse exchange of the two currencies described in (1) at a later date and at a fixed rate that is agreed upon on the inception of the contract covering the exchange. An FX forward is defined as a transaction that solely involves the exchange of two different currencies on a specific future date at a fixed rate agreed upon on the inception of the contract covering the exchange. *See* Sections 1a(25) and 1a(24) of the CEA, respectively.

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