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CLIENT MEMORANDUM

Mandatory Swap Clearing and The End-User Exception

August 1, 2013

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On December 13, 2012, the Commodity Futures Trading Commission published final regulations establishing a clearing requirement for certain classes of interest rate and credit default swaps.[1] Beginning September 9, 2013, all swaps covered by the IRS/CDS Determination must be cleared with a registered DCO, unless an exception is available.

The Clearing Deadlines

CFTC Rule 50.25 establishes a compliance schedule for clearing Accepted Swaps between different categories of entities. The clearing deadlines are tied to the publication date of the applicable clearing determination. Specifically, Accepted Swaps must be cleared beginning:

[1] Clearing Requirement Determination Under Section 2(h) of the CEA, 77 Fed. Reg. 74284 (the "IRS/CDS Determination"). A derivatives clearing organization ("DCO") that wishes to request a determination by the CFTC that a class of swap should be subject to mandatory clearing, may do so pursuant to CFTC Rule 39.5. Once the CFTC reviews the request, it may adopt regulations (a "clearing determination") establishing a clearing requirement for the class of swap covered in the request (an "Accepted Swap").

- 90 days after the publication of the applicable clearing determination, where the Accepted Swap is between two "Category 1 Entities";[2]
- 180 days after the publication of the applicable clearing determination, where the Accepted Swap is between two "Category 2 Entities"[3] or a Category 1 Entity and a Category 2 Entity; or
- 270 days after the publication of the applicable clearing determination, where one of the counterparties to the Accepted Swap is neither a Category 1 Entity nor a Category 2 Entity.

September 9, 2013 marks the 270th day following the CFTC's publication of the IRS/CDS Determination. Thus, all Accepted Swaps covered by that clearing determination must be cleared beginning on that date, unless an exception is available.[4]

The End-User Exception

A counterparty to an Accepted Swap may elect not to clear such swap if the party (i) is not a "financial entity,"[5] (ii) is using the swap to hedge or mitigate commercial risk[6] and (iii) provides, either directly or through its swap dealer, certain other

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2 A "Category 1 Entity" includes a swap dealer, a security-based swap dealer, a major swap participant, a major security-based swap participant, and an "active fund" (i.e., a private fund as defined in section 202(a) of the Investment Advisers Act of 1940 (the "1940 Act") that is not a "third-party subaccount" and that executes 200 or more swaps per month based on a monthly average over the 12 months preceding the CFTC issuing a clearing determination). A "third-party subaccount" is an account that is managed by an investment manager that is independent of and unaffiliated with the account's beneficial owner or sponsor, and who is responsible for the documentation necessary for the account's beneficial owner to clear swaps.

3 A "Category 2 Entity" includes a commodity pool, a private fund as defined in section 202(a) of the 1940 Act other than an active fund, or a person predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature as defined in section 4(k) of the Bank Holding Company Act of 1956, provided that, in each case, the entity is not a third-party subaccount.

4 Cleared swaps will be subject to mandatory margin calls by the DCO and the swap counterparty's clearing member.

5 In general, the term "financial entity" means a Category 1 Entity, a Category 2 Entity, or an employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income Security Act of 1974.

6 A swap will generally be deemed to be used for hedging or mitigating commercial risk if, *inter alia*, the swap is "economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise," where such risks arise from: changes in assets owned or manufactured or services provided in the ordinary course by such enterprise; changes in the value of liabilities incurred in the ordinary course by such enterprise; or fluctuation in interest rate or foreign exchange exposure arising from such enterprise's current or anticipated assets or liabilities.

information to a registered swap data repository, including, but not limited to, a statement of how the electing counterparty intends to meet its financial obligations under the swap (the "End-User Exception").[7] An issuer of securities under the Securities Exchange Act of 1934 (including affiliates and subsidiaries under its control) that elects the End-User Exception must also provide its swap dealer with representations regarding whether its board, or a committee appointed by its board, has reviewed its decision to elect the End-User Exception.[8]

The ISDA March 2013 Dodd-Frank Protocol Initiative[9] includes representations that a counterparty can provide to its swap dealer for the purpose of complying with the End-User Exception. Parties can also bilaterally agree on how to satisfy the requirements of the exception.

If you have any questions concerning the matters described in this memorandum, please contact Jack I. Habert (212-728-8952, jhabert@willkie.com), Jonathan C. Burwick (212-728-8108, jburwick@willkie.com) or the Willkie attorney with whom you regularly work.

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7 End-User Exception to the Clearing Requirement for Swaps, 77 Fed. Reg. 42560 (July 19, 2012).

8 The CFTC has stated that it would expect an electing party's board, or an authorized committee of the board, to set appropriate policies regarding the End-User Exception and to review those policies at least annually.

9 For more information on the ISDA March 2013 Dodd-Frank Protocol Initiative, please see our client memorandum, dated May 29, 2013, entitled July Adherence Deadline For ISDA March 2013 Dodd-Frank Protocol.