

FX Swaps and FX Forwards Exempted from Definition of “Swap”

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On November 16, 2012, the U.S. Department of the Treasury issued a final determination that exempts FX Swaps and FX Forwards (as defined below) from the definition of “swap” under the Commodity Exchange Act (the “Exemption”).

Practical Implications for Hedge Fund Managers

As a result of the Exemption, FX Forwards and FX Swaps will generally not be subject to regulation by the CFTC and will not be subject to certain mandatory requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act, including central clearing and exchange trading.

Hedge fund managers should consider the following CFTC-related implications:

- Operators of private funds that trade FX Swaps and/or FX Forwards, but do not trade any other commodity interests, will not be required to register as commodity pool operators (“CPOs”) with the CFTC and will not need to seek an exemption from such registration.
- Private fund operators that are exempt from registration as CPOs under the CFTC’s limited trading exemption will not need to include FX Swaps or FX Forwards as “commodity interests” when calculating their compliance with such exemption.
- Because FX Swaps and FX Forwards are not defined as “swaps,” they are not considered when determining whether a fund is an “active fund” (a fund which executes 200 or more swaps per month) for purposes of complying with future mandatory clearing requirements.

Although FX Swaps and FX Forwards are generally exempt from CFTC regulation, the parties to such transactions will remain subject to the CFTC’s trade-reporting requirements, business conduct standards and anti-evasion requirements.



Limited Scope of Exemption

The Exemption applies solely to FX Swaps and FX Forwards, but not to other foreign exchange derivatives. It is important to note that the Exemption will be applied narrowly and will not provide an exemption from swap regulation for products that the CFTC has specifically deemed to be swaps, including foreign exchange options, currency swaps and non-deliverable forwards in foreign exchange. The Exemption does not impact the regulation of retail foreign exchange transactions.

- An FX Swap (foreign exchange swap), which is defined in the Commodity Exchange Act, as amended (the “CEA”), is a transaction that solely involves (i) 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 (ii) a reverse exchange of those two currencies 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 (foreign exchange forward), which is defined in the CEA, is 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.

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