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COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 23

RIN 3038-AE84

Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission ("Commission" or "CFTC") is publishing for public comment a proposed rule ("Proposed Rule") addressing the cross-border application of certain swap provisions of the Commodity Exchange Act ("CEA or "Act"), as added by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). Specifically, the Proposed Rule addresses the cross-border application of the registration thresholds and certain requirements applicable to swap dealers ("SDs") and major swap participants ("MSPs"), and establishes a formal process for requesting comparability determinations for such requirements from the Commission. The Commission is proposing a risk-based approach that, consistent with section 2(i) of the CEA, and with due consideration of international comity principles and the Commission's interest in focusing its authority on potential significant risks to the U.S. financial system, would advance the goals of the Dodd-Frank Act's swap reform, while fostering greater liquidity and competitive markets, promoting

enhanced regulatory cooperation, and advancing the global harmonization of swap regulation.

DATES: Comments must be received on or before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

ADDRESSES: You may submit comments, identified by RIN 3038-AE84, by any of the following methods:

- CFTC Comments Portal: *https://comments.cftc.gov*. Select the "Submit Comments" link for this rulemaking and follow the instructions on the Public Comment Form.

- Mail: Send to Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.

- Hand Delivery/Courier: Follow the same instructions as for Mail, above.

Please submit your comments using only one of these methods. To avoid possible delays with mail or in-person deliveries, submissions through the CFTC Comments Portal are encouraged.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to *https://comments.cftc.gov*. You should submit only information that you wish to make available publicly. If you wish for the Commission to consider information that is exempt from disclosure under the

Freedom of Information Act ("FOIA"),[1] a petition for confidential treatment of the exempt information may be submitted according to the procedures set forth in § 145.9 of the Commission's regulations.[2]

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse, or remove any or all of your submission from *https://comments.cftc.gov* that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under FOIA.

FOR FURTHER INFORMATION CONTACT: Joshua Sterling, Director, (202) 418-6056, *jsterling@cftc.gov*; Frank Fisanich, Chief Counsel, (202) 418-5949, *ffisanich@cftc.gov*; Amanda Olear, Associate Director, (202) 418-5283, *aolear@cftc.gov*; Rajal Patel, Associate Director, 202-418-5261, *rpatel@cftc.gov*; Lauren Bennett, Special Counsel, 202-418-5290, *lbennett@cftc.gov*; Jacob Chachkin, Special Counsel, (202) 418-5496, *jchachkin@cftc.gov*; Pamela Geraghty, Special Counsel, 202-418-5634, *pgeraghty@cftc.gov*; or Owen Kopon, Special Counsel, *okopon@cftc.gov*, 202-418-5360, Division of Swap Dealer and Intermediary Oversight ("DSIO"), Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.

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[1] 5 U.S.C. 552.

[2] 17 CFR 145.9. Commission regulations referred to herein are found at 17 CFR chapter I.

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I. Background

A. Statutory Authority and Prior Commission Action

In 2010, the Dodd-Frank Act[3] amended the CEA[4] to, among other things, establish a new regulatory framework for swaps. Added in the wake of the 2008 financial crisis, the Dodd-Frank Act was enacted to reduce systemic risk, increase transparency, and promote market integrity within the financial system. Given the global nature of the swap market, the Dodd-Frank Act amended the CEA by adding section 2(i) to provide that the swap provisions of the CEA enacted by Title VII of the Dodd-Frank Act ("Title VII"), including any rule prescribed or regulation promulgated under the CEA, shall not apply to activities outside the United States ("U.S.") unless those activities have a direct and significant connection with activities in, or effect on, commerce of the United States, or they contravene Commission rules or regulations as are necessary or appropriate to prevent evasion of the swap provisions of the CEA enacted under Title VII.[5]

In May 2012, the CFTC and Securities and Exchange Commission ("SEC") jointly issued an adopting release that, among other things, further defined and provided

[3] Pub. L. 111–203, 124 Stat. 1376 (2010).
[4] 7 U.S.C. 1 *et seq*.
[5] 7 U.S.C. 2(i).

registration thresholds for SDs and MSPs in § 1.3 of the CFTC's regulations ("Entities Rule").[6]

In July 2013, the Commission published interpretive guidance and a policy statement regarding the cross-border application of certain swap provisions of the CEA ("Guidance").[7] The Guidance included the Commission's interpretation of the "direct and significant" prong of section 2(i) of the CEA.[8] In addition, the Guidance established a general, non-binding framework for the cross-border application of many substantive Dodd-Frank Act requirements, including registration and business conduct requirements for SDs and MSPs, as well as a process for making substituted compliance determinations. Given the complex and dynamic nature of the global swap market, the Guidance was intended as a flexible and efficient way to provide the Commission's views on cross-border issues raised by market participants, allowing the Commission to adapt in response to changes in the global regulatory and market landscape.[9] The Commission accordingly stated that it would review and modify its cross-border policies as the global swap market continued to evolve and consider codifying the cross-border application of the Dodd-Frank Act swap provisions in future rulemakings, as appropriate.[10] The Commission notes that, at the time that the Guidance was adopted, it was tasked with regulating a market that grew to a global scale without any meaningful

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[6] *See* 17 CFR 1.3, "Swap dealer" and "Major swap participant"; Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 FR 30596 (May 23, 2012).
[7] *See* Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 FR 45292 (Jul. 26, 2013).
[8] *Id.* at 45297-301. The Commission is now restating this interpretation, as discussed in section I.C below.
[9] *Id.* at 45297 n.39.
[10] *See id.*

regulation in the United States or overseas, and that the United States was the first of the G20 member countries to adopt most of the swap reforms agreed to at the G20 Pittsburgh Summit in 2009.[11] Developing a regulatory framework to fit that market necessarily requires adapting and responding to changes in the global market, including developments resulting from requirements imposed on market participants under the Dodd-Frank Act and the Commission's implementing regulations in the U.S., as well as those that have been imposed by non-U.S. regulatory authorities since the Guidance was issued.

On November 14, 2013, DSIO issued a staff advisory ("ANE Staff Advisory") stating that a non-U.S. SD that regularly uses personnel or agents located in the United States to arrange, negotiate, or execute a swap with a non-U.S. person ("ANE Transactions") would generally be required to comply with "Transaction-Level Requirements," as the term was used in the Guidance (discussed in section VI.A).[12] On November 26, 2013, Commission staff issued certain no-action relief to non-U.S. SDs registered with the Commission from these requirements in connection with ANE Transactions ("ANE No-Action Relief").[13] In January 2014, the Commission published a

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[11] *See* G20 Leaders' Statement: The Pittsburgh Summit, A Framework for Strong, Sustainable, and Balanced Growth (Sep. 24-25, 2009), available at https://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf.

[12] *See* CFTC Staff Advisory No. 13-69, Applicability of Transaction-Level Requirements to Activity in the United States (Nov. 14, 2013), available at http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/13-69.pdf.

[13] CFTC Staff Letter No. 13-71, No-Action Relief: Certain Transaction-Level Requirements for Non-U.S. Swap Dealers (Nov. 26, 2013), available at https://www.cftc.gov/csl/13-71/download. Commission staff subsequently extended this relief in CFTC Letter Nos. 14-01, 14-74, 14-140, 15-48, 16-64, and 17-36. All Commission staff letters are available at https://www.cftc.gov/LawRegulation/CFTCStaffLetters/index.htm.

request for comment on all aspects of the ANE Staff Advisory ("ANE Request for Comment").[14]

In May 2016, the Commission issued a final rule on the cross-border application of the Commission's margin requirements for uncleared swaps ("Cross-Border Margin Rule").[15] Among other things, the Cross-Border Margin Rule addressed the availability of substituted compliance by outlining the circumstances under which certain SDs and MSPs could satisfy the Commission's margin requirements for uncleared swaps by complying with comparable foreign margin requirements. The Cross-Border Margin Rule also established a framework by which the Commission would assess whether a foreign jurisdiction's margin requirements are comparable.

In October 2016, the Commission proposed regulations regarding the cross-border application of certain requirements under the Dodd-Frank Act regulatory framework for SDs and MSPs ("2016 Proposal").[16] The 2016 Proposal incorporated various aspects of the Cross-Border Margin Rule and addressed when U.S. and non-U.S. persons, such as foreign consolidated subsidiaries ("FCSs") and non-U.S. persons whose swap obligations are guaranteed by a U.S. person, would be required to include swaps or swap positions in their SD or MSP registration threshold calculations, respectively.[17] The 2016 Proposal also addressed the extent to which SDs and MSPs would be required to comply with the

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[14] Request for Comment on Application of Commission Regulations to Swaps Between Non-U.S. Swap Dealers and Non-U.S. Counterparties Involving Personnel or Agents of the Non-U.S. Swap Dealers Located in the United States, 79 FR 1347, 1348-49 (Jan. 8, 2014).

[15] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Cross-Border Application of the Margin Requirements, 81 FR 34818 (May 31, 2016).

[16] Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants, 81 FR 71946 (proposed Oct. 18, 2016).

[17] *Id.* at 71947. As noted above, the SD and MSP registration thresholds are codified in the definitions of those terms at 17 CFR 1.3.

Commission's business conduct standards governing their conduct with swap counterparties ("external business conduct standards") in cross-border transactions.[18] In addition, the 2016 Proposal addressed ANE Transactions, including the types of activities that would constitute arranging, negotiating, and executing within the context of the 2016 Proposal, the treatment of such transactions with respect to the SD registration threshold, and the application of external business conduct standards with respect to such transactions.[19]

The Commission is today withdrawing the 2016 Proposal. The Proposed Rule reflects the Commission's current views on the matters addressed in the 2016 Proposal, which have evolved since the 2016 Proposal as a result of market and regulatory developments in the swap markets and in the interest of international comity, as discussed in this release.

B. Global Regulatory and Market Structure

The regulatory landscape is far different now than it was when the Dodd-Frank Act was enacted. Even when the CFTC published the Guidance in 2013, very few jurisdictions had made significant progress in implementing the global swap reforms to which the G20 leaders agreed at the Pittsburgh G20 Summit. Today, however, as a result of the cumulative implementation efforts by regulators throughout the world, significant progress has been made by regulators in the world's primary swap trading jurisdictions to

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[18] *Id.* The Commission's external business conduct standards are codified in 17 CFR part 23, subpart H (17 CFR 23.400 through 23.451).
[19] *Id.*

implement the G20 commitments.[20] Since the enactment of the Dodd-Frank Act, regulators in a number of large developed markets have adopted regulatory regimes that are designed to mitigate systemic risks associated with a global swap market. Regulators have adopted rules regarding matters including central clearing, margin requirements for non-centrally cleared derivatives, and other risk mitigation requirements.[21]

Many swaps involve at least one counterparty that is located in the United States or another jurisdiction that has adopted comprehensive swap regulations.[22] However, conflicting and duplicative requirements between U.S. and foreign regimes can contribute to potential market inefficiencies and regulatory arbitrage, as well as competitive disparities that undermine the relative positions of U.S. SDs and their counterparties. This may result in market fragmentation, which can lead to significant inefficiencies that result in additional costs to end-users. Market fragmentation can reduce the capacity of financial firms to serve both domestic and international customers.[23] The Proposed Rule has been designed to support a cross-border framework that promotes the integrity, resilience, and vibrancy of the swap market while furthering the important policy goals of the Dodd-Frank Act. In that regard, giving due regard to how market practices have

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[20] *See, e.g.,* Financial Stability Board ("FSB"), OTC Derivatives Market Reforms: 2019 Progress Report on Implementation (Oct. 15, 2019) ("2019 FSB Progress Report"), available at https://www.fsb.org/wp-content/uploads/P151019.pdf; and FSB, Implementation and Effects of the G20 Financial Regulatory Reforms: Fourth Annual Report (Nov. 28, 2018), available at http://www.fsb.org/wp-content/uploads/P281118-1.pdf.

[21] For example, at the end of September 2019, 16 FSB member jurisdictions had comprehensive swap margin requirements in force. *See* 2019 FSB Progress Report, at 2.

[22] *See, e.g.*, 2019 FSB Progress Report; and Bank of International Settlements ("BIS"), Triennial Central Bank Survey of Foreign Exchange and Over-the-counter Derivatives Markets in 2019 (Sep. 16, 2019), available at https://www.bis.org/statistics/rpfx19.htm.

[23] *See, e.g.,* Institute of International Finance, Addressing Market Fragmentation: The Need for Enhanced Global Regulatory Cooperation (Jan. 2019), available at https://www.iif.com/Portals/0/Files/IIF%20FSB%20Fragmentation%20Report.pdf.

evolved since the publication of the Guidance is an important consideration. As certain market participants may have adjusted their practices to take the Guidance into account, the Proposed Rule, if adopted, should cause limited additional costs and burdens for these market participants if it is adopted, while supporting the continued operation of markets that are much more comprehensively regulated than they were before the Dodd-Frank Act and the actions of governments worldwide taken in response to the Pittsburgh G20 Summit.

The approach described below is informed by the Commission's understanding of current market practices of global financial institutions under the Guidance. Driven by business and regulatory reasons, a financial group that is active in the swap market often operates in multiple market centers around the world and carries out swap activity with geographically-diverse counterparties using a number of different operational structures.[24] From discussions with market participants, the Commission understands that financial groups typically prefer to operate their swap dealing businesses and manage swap portfolios in the jurisdiction where the swaps and the underlying assets have the deepest and most liquid markets. In operating their swap dealing businesses in these market centers, financial groups seek to take advantage of expertise in products traded in those centers and obtain access to greater liquidity. These arrangements permit them to

[24] *See* BIS, Committee on the Global Financial System, No. 46, The macrofinancial implications of alternative configurations for access to central counterparties in OTC derivatives markets, at 1 (Nov. 2011), available at http://www.bis.org/publ/cgfs46.pdf (stating that "[t]he configuration of access must take account of the globalised nature of the market, in which a significant proportion of OTC derivatives trading is undertaken across borders").

price products more efficiently and compete more effectively in the global swap market, including in jurisdictions different from the market center in which the swap is traded.

In this sense, a global financial enterprise effectively operates as a single business, with a highly integrated network of business lines and services conducted through various branches or affiliated legal entities that are under the control of the parent entity.[25] Branches and affiliates in a global financial enterprise are highly interdependent, with separate entities in the group providing financial or credit support to each other, such as in the form of a guarantee or the ability to transfer risk through inter-affiliate trades or other offsetting transactions. Even in the absence of an explicit arrangement or guarantee, a parent entity may, for reputational or other reasons, choose to assume the risk incurred by its affiliates, branches, or offices located overseas. Swaps are also traded by an entity in one jurisdiction, but booked and risk-managed by an affiliate in another jurisdiction. The Proposed Rule recognizes that these and similar arrangements among global financial enterprises create channels through which swap-related risks can have a direct and significant connection with activities in, or effect on, commerce of the United States.

C. *Interpretation of CEA Section 2(i)*

The Commission's interpretation of CEA section 2(i) in this release mirrors the approach that the Commission took in the Guidance. However, in light of the passage of

[25] The largest U.S. banks have thousands of affiliated global entities, as shown in data from the National Information Center ("NIC"), a repository of financial data and institutional characteristics of banks and other institutions for which the Federal Reserve Board has a supervisory, regulatory, or research interest. *See* NIC, available at https://www.ffiec.gov/npw.

time since the publication of the Guidance, the Commission is restating its interpretation of section 2(i) of the CEA with the Proposed Rule.

CEA section 2(i) provides that the swap provisions of Title VII shall not apply to activities outside the United States unless those activities –

- have a direct and significant connection with activities in, or effect on, commerce of the United States; or
- contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of the CEA that was enacted by the Dodd-Frank Act.

The Commission believes that section 2(i) provides it express authority over swap activities outside the United States when certain conditions are met, but it does not require the Commission to extend its reach to the outer bounds of that authorization. Rather, in exercising its authority with respect to swap activities outside the United States, the Commission will be guided by international comity principles and will focus its authority on potential significant risks to the U.S. financial system.

1. Statutory Analysis

In interpreting the phrase "direct and significant," the Commission has examined the plain language of the statutory provision, similar language in other statutes with cross-border application, and the legislative history of section 2(i).

The statutory language in CEA section 2(i) is structured similarly to the statutory language in the Foreign Trade Antitrust Improvements Act of 1982 ("FTAIA"),[26] which provides the standard for the cross-border application of the Sherman Antitrust Act ("Sherman Act").[27] The FTAIA, like CEA section 2(i), excludes certain non-U.S. commercial transactions from the reach of U.S. law. Specifically, the FTAIA provides that the antitrust provisions of the Sherman Act shall not apply to anti-competitive conduct involving trade or commerce with foreign nations.[28] However, like paragraph (1) of CEA section 2(i), the FTAIA also creates exceptions to the general exclusionary rule and thus brings back within antitrust coverage any conduct that: (1) has a direct, substantial, and reasonably foreseeable effect on U.S. commerce;[29] and (2) such effect gives rise to a Sherman Act claim.[30] In *F. Hoffman-LaRoche, Ltd. v. Empagran S.A.*, the U.S. Supreme Court stated that "this technical language initially lays down a general rule placing *all* (nonimport) activity involving foreign commerce outside the Sherman Act's reach. It then brings such conduct back within the Sherman Act's reach *provided that* the conduct *both* (1) sufficiently affects American commerce, *i.e.*, it has a 'direct, substantial, and reasonably foreseeable effect' on American domestic, import, or (certain) export commerce, *and* (2) has an effect of a kind that antitrust law considers harmful, *i.e.*, the 'effect' must 'giv[e] rise to a [Sherman Act] claim.'"[31]

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[26] 15 U.S.C. 6a.
[27] 15 U.S.C. 1-7.
[28] 15 U.S.C. 6a.
[29] 15 U.S.C. 6a(1).
[30] 15 U.S.C. 6a(2).
[31] 542 U.S. 155, 162 (2004) (emphasis in original).

It is appropriate, therefore, to read section 2(i) of the CEA as a clear expression of congressional intent that the swap provisions of Title VII of the Dodd-Frank Act apply to activities beyond the borders of the United States when certain circumstances are present.[32] These circumstances include, pursuant to paragraph (1) of section 2(i), when activities outside the United States meet the statutory test of having a "direct and significant connection with activities in, or effect on," U.S. commerce.

An examination of the language in the FTAIA, however, does not provide an unambiguous roadmap for the Commission in interpreting section 2(i) of the CEA because there are both similarities, and a number of significant differences, between the language in CEA section 2(i) and the language in the FTAIA. Further, the Supreme Court has not provided definitive guidance as to the meaning of the direct, substantial, and reasonably foreseeable test in the FTAIA, and the lower courts have interpreted the individual terms in the FTAIA differently.

Although a number of courts have interpreted the various terms in the FTAIA, only the term "direct" appears in both CEA section 2(i) and the FTAIA.[33] Relying upon the Supreme Court's definition of the term "direct" in the Foreign Sovereign Immunities Act ("FSIA"),[34] the U.S. Court of Appeals for the Ninth Circuit construed the term

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[32] *SIFMA v. CFTC*, 67 F.Supp.3d 373, 425-26 (D.D.C. 2014) ("The plain text of this provision 'clearly expresse[s]' Congress's 'affirmative intention' to give extraterritorial effect to Title VII's statutory requirements, as well as to the Title VII rules or regulations prescribed by the CFTC, whenever the provision's jurisdictional nexus is satisfied."). *See also Prime Int'l Trading, Ltd. v. BP P.L.C.*, 937 F.3d 94, 103 (2d Cir. 2019) (stating that "Section 2(i) contains, on its face, a 'clear statement,' *Morrison*, 561 U.S. at 265, 130 S.Ct. 2869, of extraterritorial application" and describing it as "an enumerated extraterritorial command").
[33] Guidance, 78 FR at 45299.
[34] *See* 28 U.S.C. 1605(a)(2).

"direct" in the FTAIA as requiring a "relationship of logical causation,"[35] such that "an effect is 'direct' if it follows as an immediate consequence of the defendant's activity."[36] However, in an en banc decision, *Minn-Chem, Inc. v. Agrium, Inc.*, the U.S. Court of Appeals for the Seventh Circuit held that "the Ninth Circuit jumped too quickly on the assumption that the FSIA and the FTAIA use the word 'direct' in the same way."[37] After examining the text of the FTAIA as well as its history and purpose, the Seventh Circuit found persuasive the "other school of thought [that] has been articulated by the Department of Justice's Antitrust Division, which takes the position that, for FTAIA purposes, the term 'direct' means only 'a reasonably proximate causal nexus.'"[38] The Seventh Circuit rejected interpretations of the term "direct" that included any requirement that the consequences be foreseeable, substantial, or immediate.[39] In 2014, the U.S. Court of Appeals for the Second Circuit followed the reasoning of the Seventh Circuit in the *Minn-Chem* decision.[40] That said, the Commission would like to make clear that its interpretation of CEA section 2(i) is not reliant on the reasoning of any individual judicial decision, but instead is drawn from a holistic understanding of both the statutory text *and* legal analysis applied by courts to analogous statutes and circumstances. In short, as the discussion below will illustrate, the Commission's interpretation of section 2(i) is not

[35] *United States v. LSL Biotechnologies*, 379 F.3d 672, 693 (9th Cir. 2004). "As a threshold matter, many courts have debated whether the FTAIA established a new jurisdictional standard or merely codified the standard applied in [*United States v. Aluminum Co. of Am.*, 148 F.2d 416 (2d Cir. 1945)] and its progeny. Several courts have raised this question without answering it. The Supreme Court did as much in [*Harford Fire Ins. Co. v. California*, 509 U.S. 764 (1993)]." *Id.* at 678.

[36] *Id.* at 692-3, *quoting Republic of Argentina v. Weltover, Inc.*, 504 U.S. 607, 618 (1992) (providing that, pursuant to the FSIA, 28 U.S.C. 1605(a)(2), immunity does not extend to commercial conduct outside the United States that "causes a direct effect in the United States").

[37] *Minn-Chem, Inc. v. Agrium, Inc.*, 683 F.3d 845, 857 (7th Cir. 2012) (en banc).

[38] *Id.*

[39] *Id.* at 856-57.

[40] *Lotes Co., Ltd. v. Hon Hai Precision Industry Co.*, 753 F.3d 395, 406-08 (2d Cir. 2014).

solely dependent on one's view of the Seventh Circuit's *Minn-Chem* decision, but informed by its overall understanding of the relevant legal principles.

Other terms in the FTAIA differ from the terms used in section 2(i) of the CEA. First, the FTAIA test explicitly requires that the effect on U.S. commerce be a "reasonably foreseeable" result of the conduct,[41] whereas section 2(i) of the CEA, by contrast, does not provide that the effect on U.S. commerce must be foreseeable. Second, whereas the FTAIA solely relies on the "effects" on U.S. commerce to determine cross-border application of the Sherman Act, section 2(i) of the CEA refers to both "effect" and "connection." "The FTAIA says that the Sherman Act applies to foreign 'conduct' with a certain kind of harmful domestic effect."[42] Section 2(i), by contrast, applies more broadly – not only to particular instances of conduct that have an effect on U.S. commerce, but also to activities that have a direct and significant "connection with activities in" U.S. commerce. Unlike the FTAIA, section 2(i) applies the swap provisions of the CEA to activities outside the United States that have the requisite connection with activities in U.S. commerce, regardless of whether a "harmful domestic effect" has occurred.

As the foregoing textual analysis of the relevant statutory language indicates, section 2(i) differs from its analogue in the antitrust laws. Congress delineated the cross-border scope of the Sherman Act in section 6a of the FTAIA as applying to conduct that has a "direct" and "substantial" and "reasonably foreseeable" "effect" on U.S. commerce.

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[41] *See, e.g., Animal Sciences Products. v. China Minmetals Corp.*, 654 F.3d 462, 471 (3d Cir. 2011) ("[T]he FTAIA's 'reasonably foreseeable' language imposes an objective standard: the requisite 'direct' and 'substantial' effect must have been 'foreseeable' to an objectively reasonable person.").

[42] *Hoffman-LaRoche*, 452 U.S. at 173.

In section 2(i), on the other hand, Congress did not include a requirement that the effects or connections of the activities outside the United States be "reasonably foreseeable" for the Dodd-Frank Act swap provisions to apply. Further, Congress included language in section 2(i) to apply the Dodd-Frank Act swap provisions in circumstances in which there is a direct and significant connection with activities in U.S. commerce, regardless of whether there is an effect on U.S. commerce. The different words that Congress used in paragraph (1) of section 2(i), as compared to its closest statutory analogue in section 6a of the FTAIA, inform the Commission in construing the boundaries of its cross-border authority over swap activities under the CEA.[43] Accordingly, the Commission believes it is appropriate to interpret section 2(i) such that it applies to activities outside the United States in circumstances in addition to those that would be reached under the FTAIA standard.

One of the principal rationales for the Dodd-Frank Act was the need for a comprehensive scheme of systemic risk regulation. More particularly, a primary purpose of Title VII of the Dodd-Frank Act is to address risk to the U.S. financial system created by interconnections in the swap market.[44] Title VII of the Dodd-Frank Act gave the

[43] The provision that ultimately became section 722(d) of the Dodd-Frank Act was added during consideration of the legislation in the House of Representatives. *See* 155 Cong. Rec. H14685 (Dec. 10, 2009). The version of what became Title VII that was reported by the House Agriculture Committee and the House Financial Services Committee did not include any provision addressing cross-border application. *See* 155 Cong. Rec. H14549 (Dec. 10, 2009). The Commission finds it significant that, in adding the cross-border provision before final passage, the House did so in terms that, as discussed in text, were different from, and broader than, the terms used in the analogous provision of the FTAIA.

[44] *Cf.* 156 Cong. Rec. S5818 (July 14, 2010) (statement of Sen. Lincoln) ("In 2008, our Nation's economy was on the brink of collapse. America was being held captive by a financial system that was so interconnected, so large, and so irresponsible that our economy and our way of life were about to be destroyed."), available at http://www.gpo.gov/fdsys/pkg/CREC-2010-07-14/pdf/CREC-2010-07-14.pdf; 156 Cong. Rec. S5888 (July 15, 2010) (statement of Sen. Shaheen) ("We need to put in place reforms to stop Wall Street firms from growing so big and so interconnected that they can threaten our entire

Commission new and broad authority to regulate the swap market to seek to address and mitigate risks arising from swap activities that could adversely affect the resiliency of the financial system in the future.

In global markets, the source of such risk is not confined to activities within U.S. borders. Due to the interconnectedness between firms, traders, and markets in the U.S. and abroad, a firm's failure, or trading losses overseas, can quickly spill over to the United States and affect activities in U.S. commerce and the stability of the U.S. financial system. Accordingly, Congress explicitly provided for cross-border application of Title VII to activities outside the United States that pose risks to the U.S. financial system.[45] Therefore, the Commission construes section 2(i) to apply the swap provisions of the CEA to activities outside the United States that have either: (1) a direct and significant effect on U.S. commerce; or, in the alternative, (2) a direct and significant connection

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economy."), available at http://www.gpo.gov/fdsys/pkg/CREC-2010-07-15/pdf/CREC-2010-07-15-senate.pdf; 156 Cong. Rec. S5905 (July 15, 2010) (statement of Sen. Stabenow) ("For too long the over-the-counter derivatives market has been unregulated, transferring risk between firms and creating a web of fragility in a system where entities became too interconnected to fail."), available at http://www.gpo.gov/fdsys/pkg/CREC-2010-07-15/pdf/CREC-2010-07-15-senate.pdf.

[45] The legislative history of the Dodd-Frank Act shows that in the fall of 2009, neither the Over-the-Counter Derivatives Markets Act of 2009, H.R. 3795, 111th Cong. (1st Sess. 2009), reported by the Financial Services Committee chaired by Rep. Barney Frank, nor the Derivatives Markets Transparency and Accountability Act of 2009, H.R. 977, 111th Cong. (1st Sess. 2009), reported by the Agriculture Committee chaired by Rep. Collin Peterson, included a general territoriality limitation that would have restricted Commission regulation of transactions between two foreign persons located outside of the United States. During the House Financial Services Committee markup on October 14, 2009, Rep. Spencer Bachus offered an amendment that would have restricted the jurisdiction of the Commission over swaps between non-U.S. resident persons transacted without the use of the mails or any other means or instrumentality of interstate commerce. Chairman Frank opposed the amendment, noting that there may well be cases where non-U.S. residents are engaging in transactions that have an effect on the United States and that are insufficiently regulated internationally and that he would not want to prevent U.S. regulators from stepping in. Chairman Frank expressed his commitment to work with Rep. Bachus going forward, and Rep. Bachus withdrew the amendment. *See* H. Fin. Serv. Comm. Mark Up on Discussion Draft of the Over-the-Counter Derivatives Markets Act of 2009, 111th Cong., 1st Sess. (Oct. 14, 2009) (statements of Rep. Bachus and Rep. Frank), available at http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=231922.

with activities in U.S. commerce, and through such connection present the type of risks to the U.S. financial system and markets that Title VII directed the Commission to address. The Commission interprets section 2(i) in a manner consistent with the overall goals of the Dodd-Frank Act to reduce risks to the resiliency and integrity of the U.S. financial system arising from swap market activities.[46] Consistent with this overall interpretation, the Commission interprets the term "direct" in section 2(i) to require a reasonably proximate causal nexus, and not to require foreseeability, substantiality, or immediacy.

Further, the Commission does not read section 2(i) to require a transaction-by-transaction determination that a specific swap outside the United States has a direct and significant connection with activities in, or effect on, commerce of the United States to apply the swap provisions of the CEA to such transaction. Rather, it is the connection of swap activities, viewed as a class or in the aggregate, to activities in commerce of the United States that must be assessed to determine whether application of the CEA swap provisions is warranted.[47]

This conclusion is bolstered by similar interpretations of other federal statutes regulating interstate commerce. For example, the Supreme Court has long supported a

[46] The Commission also notes that the Supreme Court has indicated that the FTAIA may be interpreted more broadly when the government is seeking to protect the public from anticompetitive conduct than when a private plaintiff brings suit. *See Hoffman-LaRoche*, 452 U.S. at 170 ("A Government plaintiff, unlike a private plaintiff, must seek to obtain the relief necessary to protect the public from further anticompetitive conduct and to redress anticompetitive harm. And a Government plaintiff has legal authority broad enough to allow it to carry out its mission.").

[47] The Commission believes this interpretation is supported by Congress's use of the plural term "activities" in CEA section 2(i), rather than the singular term "activity." The Commission believes it is reasonable to interpret the use of the plural term "activities" in section 2(i) to require not that each particular activity have the requisite connection with U.S. commerce, but rather that such activities in the aggregate, or a class of activity, have the requisite nexus with U.S. commerce. This interpretation is consistent with the overall objectives of Title VII, as described above. Further, the Commission believes that a swap-by-swap approach to jurisdiction would be "too complex to prove workable." *See Hoffman-LaRoche*, 542 U.S. at 168.

similar "aggregate effects" approach when analyzing the reach of U.S. authority under the Commerce Clause.[48] For example, the Court phrased the holding in the seminal "aggregate effects" decision, *Wickard v. Filburn*,[49] in this way: "[The farmer's] decision, when considered in the aggregate along with similar decisions of others, would have had a substantial effect on the interstate market for wheat."[50] In another relevant decision, *Gonzales v Raich*,[51] the Court adopted similar reasoning to uphold the application of the Controlled Substance Act[52] to prohibit the intrastate use of medical marijuana for medicinal purposes. In *Raich*, the Court held that Congress could regulate purely intrastate activity if the failure to do so would "leave a gaping hole" in the federal regulatory structure. These cases support the Commission's cross-border authority over swap activities that as a class, or in the aggregate, have a direct and significant connection with activities in, or effect on, U.S. commerce – whether or not an individual swap may satisfy the statutory standard.[53]

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[48] Nat'l Fed'n of Indep. Bus. v. Sebelius, 567 U.S. 519 (2012).

[49] 317 U.S. 111 (1942).

[50] 567 U.S. at 552-53. At issue in *Wickard* was the regulation of a farmer's production and use of wheat even though the wheat was "not intended in any part for commerce but wholly for consumption on the farm." 317 U.S. at 118. The Supreme Court upheld the application of the regulation, stating that although the farmer's "own contribution to the demand for wheat may be trivial by itself," the federal regulation could be applied when his contribution "taken together with that of many others similarly situated, is far from trivial." *Id.* at 128-29. The Court also stated it had "no doubt that Congress may properly have considered that wheat consumed on the farm where grown, if wholly outside the scheme of regulation, would have a substantial effect in defeating and obstructing its purpose …." *Id.*

[51] 545 U.S. 1 (2005).

[52] 21 U.S.C. 801 *et seq.*

[53] In *Sebelius*, the Court stated in dicta, "Where the class of activities is regulated, and that class is within the reach of federal power, the courts have no power to excise, as trivial, individual instances of the class." 567 U.S. at 551 (*quoting Perez v. United States*, 402 U.S. 146, 154 (1971)). *See also Taylor v. U.S.*136 S. Ct. 2074, 2079 (2016) ("[A]ctivities … that "substantially affect" commerce … may be regulated so long as they substantially affect interstate commerce in the aggregate, even if their individual impact on interstate commerce is minimal.")

2. Principles of International Comity

Principles of international comity counsel the government in one country to act reasonably in exercising its jurisdiction with respect to activity that takes place in another country. Statutes should be construed to "avoid unreasonable interference with the sovereign authority of other nations."[54] This rule of construction "reflects customary principles of international law" and "helps the potentially conflicting laws of different nations work together in harmony – a harmony particularly needed in today's highly interdependent commercial world."[55]

The Restatement (Third) of Foreign Relations Law of the United States,[56] together with the Restatement (Fourth) of Foreign Relations Law of the United States[57] (collectively, the "Restatement"), provides that a country has jurisdiction to prescribe law with respect to "conduct outside its territory that has or is intended to have substantial effect within its territory."[58] The Restatement also provides that even where a country has a basis for extraterritorial jurisdiction, it should not prescribe law with respect to a person or activity in another country when the exercise of such jurisdiction is unreasonable.[59]

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[54] *Hoffman-LaRoche*, 542 U.S. at 164.
[55] *Id.* at 165.
[56] Restatement (Third) section 402 cmt. d (1987).
[57] Julian Ku, American Law Institute Approves First Portions of Restatement on Foreign Relations Law (Fourth), OpinioJuris.com, May 22, 2017, http://opiniojuris.org/2017/05/22/american-law-institute-approves-first-portions-of-restatement-on-foreign-relations-law-fourth/; Jennifer Morinigo, U.S. Foreign Relations Law, Jurisdiction Approved, ALI Adviser, May 22, 2017, http://www.thealiadviser.org/us-foreign-relations-law/jurisdiction-approved/; Restatement (Fourth) of Foreign Relations Law Intro. (Westlaw 2018) (explaining that "this is only a partial revision" of the Third Restatement).
[58] Restatement (Fourth) section 409 (Westlaw 2018).
[59] Restatement (Fourth) section 405 cmt. a (Westlaw 2018); *see id.* at section 407 Reporters' Note 3 ("Reasonableness, in the sense of showing a genuine connection, is an important touchstone for determining whether an exercise of jurisdiction is permissible under international law.").

As a general matter, the Fourth Restatement has indicated that the concept of reasonableness as it relates to foreign relations law is "a principle of statutory interpretation" that "operates in conjunction with other principles of statutory interpretation."[60] More specifically, the Fourth Restatement characterizes the inquiry into the reasonableness of exercising extraterritorial jurisdiction as an examination into whether "a genuine connection exists between the state seeking to regulate and the persons, property, or conduct being regulated."[61] The Restatement explicitly indicates that the "genuine connection" between the state and the person, property, or conduct to be regulated can derive from the effects of the particular conduct or activities in question.[62]

Consistent with the Restatement, the Commission has carefully considered, among other things, the level of the foreign jurisdiction's supervisory interests over the subject activity and the extent to which the activity takes place within the foreign territory. In doing so, the Commission has strived to minimize conflicts with the laws of other jurisdictions while seeking, pursuant to section 2(i), to apply the swaps requirements of Title VII to activities outside the United States that have a direct and significant connection with activities in, or effect on, U.S. commerce.

The Commission believes the Proposed Rule strikes an appropriate balance between these competing factors to ensure that the Commission can discharge its responsibilities to protect the U.S. markets, market participants, and financial system, consistent with international comity, as set forth in the Restatement. Of particular

[60] *Id.* at section 405 cmt. a.
[61] *Id.* at section 407 cmt. a; *see id.* at section 407 Reporters' Note 3.
[62] *Id.* at section 407.

relevance is the Commission's approach to substituted compliance in the Proposed Rule, which would mitigate burdens associated with potentially conflicting foreign laws and regulations in light of the supervisory interests of foreign regulators in entities domiciled and operating in their own jurisdictions.

D. Proposed Rule

The Proposed Rule addresses which cross-border swaps or swap positions a person would need to consider when determining whether it needs to register with the Commission as an SD or MSP, as well as related classifications of swap market participants and swaps (*e.g.*, U.S. person, foreign branch, swap conducted through a foreign branch).[63] Further, the Commission is proposing exceptions from, and a substituted compliance process for, certain regulations applicable to registered SDs and MSPs. The Proposed Rule also would create a framework for comparability determinations for such regulations that emphasizes a holistic, outcomes-based approach that is grounded in principles of international comity. Finally, the Proposed Rule would require SDs and MSPs to create a record of their compliance with the Proposed Rule and to retain such records in accordance with § 23.203.[64] If adopted, the Proposed Rule would supersede the Commission's policy views with respect to its interpretation of section 2(i) of the CEA and the covered swap provisions, as set forth in the Guidance.[65]

[63] There were no MSPs registered with the Commission as of the date of the Proposed Rule.
[64] *See* Proposed § 23.23(h).
[65] The Commission notes that, if adopted, the Proposed Rule would also cause the Commission's Title VII requirements addressed in section VI of this release to become "Addressed Transaction-Level Requirements" under the terms of CFTC Staff Letter No. 17-36, Extension of No-Action Relief: Transaction-Level Requirements for Non-U.S. Swap Dealers (July 25, 2017), available at https://www.cftc.gov/csl/17-36/download, such that relief for such requirements would no longer be

The Proposed Rule would not supersede the Commission's policy views as stated in the Guidance or elsewhere with respect to any other matters.

The Proposed Rule takes into account the Commission's experience implementing the Dodd-Frank Act reforms, including its experience with the Guidance and the Cross-Border Margin Rule, comments submitted in connection with the ANE Request for Comment, as well as discussions that the Commission and its staff have had with market participants, other domestic[66] and foreign regulators, and other interested parties. It is essential that a cross-border framework recognize the global nature of the swap market and the supervisory interests of foreign regulators with respect to entities and transactions covered by the Commission's swap regime.[67] In determining the extent to which the Dodd-Frank Act swap provisions addressed by the Proposed Rule would apply to activities outside the United States, the Commission has strived to protect U.S. interests as contemplated by Congress in Title VII, and minimize conflicts with the laws of other jurisdictions. The Commission has carefully considered, among other things, the level of a home jurisdiction's supervisory interests over the subject activity and the extent

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available under that letter. The treatment of the Commission's other Title VII Requirements under the letter would not be affected by the finalization of the Proposed Rule.

[66] The Commission notes that it has consulted with the Securities and Exchange Commission ("SEC") and prudential regulators regarding the Proposed Rule, as required by section 712(a)(1) of the Dodd-Frank Act for the purposes of assuring regulatory consistency and comparability, to the extent possible. Dodd-Frank Act, Pub. L. 111–203, section 712(a)(1); 15 U.S.C. 8302(a)(1). SEC staff was consulted to increase understanding of each other's regulatory approaches and to harmonize the cross-border approaches of the two agencies to the extent possible, consistent with their respective statutory mandates. As noted in the Entities Rule, the CFTC and SEC intended to address the cross-border application of Title VII in separate releases. *See* Entities Rule, 77 FR at 30628 n.407.

[67] As discussed above, in developing the Proposed Rule, the Commission is guided by principles of international comity, which counsels due regard for the important interests of foreign sovereigns. *See* Restatement.

to which the activity takes place within the home country's territory.[68] At the same time, the Commission has also considered the potential for cross-border activities to have a significant connection with activities in, or effect on, commerce of the United States, as well as the global, highly integrated nature of today's swap markets. To fulfill the purposes of the Dodd-Frank Act swap reform, the Commission's supervisory oversight cannot be confined to activities strictly within the territory of the United States. In exercising its supervisory oversight outside the United States, however, the Commission will do so only as necessary to address risk to the resiliency and integrity of the U.S. financial system.[69] The Commission will also strive to show deference to non-U.S. regulation when such regulation achieves comparable outcomes to mitigate unnecessary conflict with effective non-U.S. regulatory frameworks and limit fragmentation of the global marketplace.

The Commission has also sought to target those classes of entities whose activities – due to the nature of their relationship with a U.S. person or U.S. commerce – most clearly present the risks addressed by the Dodd-Frank Act provisions, and related regulations covered by the Proposed Rule. The Proposed Rule is designed to limit opportunities for regulatory arbitrage by applying the registration thresholds in a consistent manner to differing organizational structures that serve similar economic functions or have similar economic effects. At the same time, the Commission is mindful of the impact of its choices on market efficiency and competition, as well as the

[68] The terms "home jurisdiction" or "home country" are used interchangeably in this release and refer to the jurisdiction in which the person or entity is established, including the European Union.
[69] *See supra* section I.C.

importance of international comity when exercising the Commission's authority. The Commission believes that the Proposed Rule reflects a measured approach that advances the goals underlying SD and MSP regulation, consistent with the Commission's statutory authority, while mitigating market distortions and inefficiencies, and avoiding fragmentation.

II. Key Definitions

The Commission is proposing to define certain terms for the purpose of applying the Dodd-Frank Act swap provisions addressed by the Proposed Rule to cross-border transactions. If adopted, certain of these definitions would be relevant in assessing whether a person's activities have the requisite "direct and significant" connection with activities in, or effect on, U.S. commerce within the meaning of CEA section 2(i). Specifically, the definitions would be relevant in determining whether certain swaps or swap positions would need to be counted toward a person's SD or MSP threshold and in addressing the cross-border application of certain Dodd-Frank Act requirements (as discussed below in sections III through VI).

The Commission acknowledges that the information necessary for a swap counterparty to accurately assess whether its counterparty or a specific swap meet one or more of the definitions discussed below may be unavailable, or available only through overly burdensome due diligence. For this reason, the Commission believes that a market participant should generally be permitted to reasonably rely on written counterparty representations in each of these respects.[70] Therefore, proposed § 23.23(a)

[70] *See* Cross-Border Margin Rule, 81 FR at 34827; Guidance, 78 FR at 45315.

states that a person may rely on a written representation from its counterparty that the counterparty does or does not satisfy the criteria for one or more of the definitions below, unless such person knows or has reason to know that the representation is not accurate. For the purposes of this rule a person would have reason to know the representation is not accurate if a reasonable person should know, under all of the facts of which the person is aware, that it is not accurate. The Commission notes that this is consistent with: (1) the reliance standard articulated in the Commission's external business conduct rules;[71] (2) the Commission's approach in the Cross-Border Margin Rule;[72] and (3) the reliance standard articulated in the "U.S. person" and "transaction conducted through a foreign branch" definitions adopted by the SEC in its rule addressing the regulation of cross-border securities-based swap activities ("SEC Cross-Border Rule").[73]

A. U.S. Person, Non-U.S. Person, and United States

Under the Proposed Rule, a "U.S. person" would be defined as set forth below, consistent with the definition of "U.S. person" adopted by the SEC in the context of its regulations regarding cross-border securities-based swap activities.[74] The Commission believes that such harmonization is appropriate, given that some firms may register both as SDs with the Commission and as security-based swap dealers with the SEC. The proposed definition of "U.S. person" also is consistent with the Commission's statutory

[71] *See* 17 CFR 23.402(d).
[72] *See* Cross-Border Margin Rule, 81 FR at 34827.
[73] *See* 17 CFR 240.3a71-3(a)(3)(ii) & (4)(iv); Application of "Security-Based Swap Dealer" and "Major Security-Based Swap Participant" Definitions to Cross-Border Security-Based Swap Activities; Republication, 79 FR 47278, 47313 (Aug. 12, 2014).
[74] *See* 17 CFR 240.3a71-3(a)(4). *See also* SEC Cross-Border Rule, 79 FR at 47303-13.

mandate under the CEA, and in this regard is largely consistent with the definition of "U.S. person" in the Cross-Border Margin Rule:[75]

(1) A natural person resident in the United States;[76]

(2) A partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the United States or having its principal place of business in the United States;[77]

(3) An account (whether discretionary or non-discretionary) of a U.S. person;[78] or

(4) An estate of a decedent who was a resident of the United States at the time of death.[79]

The Commission believes that this definition offers a clear, objective basis for determining which individuals or entities should be identified as U.S. persons for purposes of the swap requirements addressed by the Proposed Rule. Specifically, the various prongs, as discussed in more detail below, are intended to identify persons whose activities have a significant nexus to the United States by virtue of their organization or domicile in the United States. In addition, harmonizing with the definition in the SEC Cross-Border Rule is not only consistent with section 2(i) of the CEA,[80] but is expected to reduce undue compliance costs for market participants. As discussed below, the

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[75] *See* 17 CFR 23.160(a)(10). *See also* Cross-Border Margin Rule, 81 FR at 34821-24.
[76] Proposed § 23.23(a)(22)(i)(*1*).
[77] Proposed § 23.23(a)(22)(i)(*2*).
[78] Proposed § 23.23(a)(22)(i)(*3*).
[79] Proposed § 23.23(a)(22)(i)(*4*).
[80] Harmonizing the Commission's definition of "U.S. person" with the definition in the SEC Cross-Border Rule also is consistent with the dictate in section 712(a)(7) of the Dodd-Frank Act that the CFTC and SEC "treat functionally or economically similar" SDs, MSPs, security-based swap dealers, and major security-based swap participants "in a similar manner." Dodd Frank Act, Pub. L. 111–203, section 712(a)(7)(A); 15 U.S.C. 8307(a)(7)(A).

Commission is also of the view that the "U.S. person" definition in the Cross-Border Margin Rule would largely encompass the same universe of persons as the definition used in the SEC Cross-Border Rule and the Proposed Rule.[81]

Proposed § 23.23(a)(22)(i) identifies certain persons as a "U.S. person" by virtue of their domicile or organization within the United States. The Commission has traditionally looked to where a legal entity is organized or incorporated (or in the case of a natural person, where he or she resides) to determine whether it is a U.S. person.[82] In the Commission's view, these persons – by virtue of their decision to organize or locate in the United States and because they are likely to have significant financial and legal relationships in the United States – are appropriately included within the definition of "U.S. person."

More specifically, proposed §§ 23.23(a)(22)(i)(*1*) and (*2*) generally incorporate a "territorial" concept of a U.S. person. That is, these are natural persons and legal entities that are physically located or incorporated within U.S. territory, and thus are subject to the Commission's jurisdiction. Further, the Commission would generally consider swap activities where such persons are counterparties, as a class and in the aggregate, as satisfying the "direct and significant" test under CEA section 2(i). Consistent with the

[81] *See* Cross-Border Margin Rule, 81 FR at 34824 ("The Commission notes that, as discussed in the proposed rule, the Final Rule defines 'U.S. person' in a manner that is substantially similar to the definition used by the SEC in the context of cross-border regulation of security-based swaps.") As noted below, the Commission also requests comment on whether it should instead adopt the "U.S. person" definition in the Cross-Border Margin Rule.

[82] *See id.* at 34823. *See also* 17 CFR 4.7(a)(1)(iv) (defining "Non-United States person" for purposes of part 4 of the Commission regulations relating to commodity pool operators).

"U.S. person" definition in the Cross-Border Margin Rule[83] and the SEC Cross-Border Rule,[84] the definition encompasses both foreign and domestic branches of an entity. As discussed below, a branch does not have a legal identity apart from its principal entity.

In addition, the Commission is of the view that proposed § 23.23(a)(22)(i)(*2*) subsumes the pension fund prong of the "U.S. person" definition in the Cross-Border Margin Rule.[85] Specifically, § 23.23(a)(22)(i)(*2*) would also include in the definition of the term "U.S. person" pension plans for the employees, officers, or principals of a legal entity described in § 23.23(a)(22)(i)(*2*). Although the SEC Cross-Border Rule directly addresses pension funds only in the context of international financial institutions, discussed below, the Commission believes it is important to clarify that pension funds in other contexts could meet the requirements of proposed § 23.23(a)(22)(i)(*2*).

Finally, the Commission is of the view that proposed § 23.23(a)(22)(i)(*2*) subsumes the trust prong of the "U.S. person" definition in the Cross-Border Margin Rule.[86] With respect to trusts addressed in proposed § 23.23(a)(22)(i)(*2*), the Commission expects that its approach would be consistent with the manner in which trusts are treated for other purposes under the law. The Commission has considered that

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[83] *See* 17 CFR 23.160(a)(10)(iii) (U.S. person includes a corporation, partnership, limited liability company, business or other trust, association, joint-stock company, fund or any form of entity similar to any of the foregoing (other than an entity described in paragraph (a)(10)(iv) or (v) of this section) (a legal entity), in each case that is organized or incorporated under the laws of the United States or that has its principal place of business in the United States, *including any branch of such legal entity*) (emphasis added).

[84] *See* SEC Cross-Border Rule, 79 FR at 47308 ("[T]he final definition determines a legal person's status at the entity level and thus applies to the entire legal person, including any foreign operations that are part of the U.S. legal person. Consistent with this approach, a foreign branch, agency, or office of a U.S. person is treated as part of a U.S. person, as it lacks the legal independence to be considered a non-U.S. person for purposes of Title VII even if its head office is physically located within the United States.").

[85] *See* 17 CFR 23.160(a)(10)(iv).

[86] *See* 17 CFR 23.160(a)(10)(v).

each trust is governed by the laws of a particular jurisdiction, which may depend on steps taken when the trust was created or other circumstances surrounding the trust. The Commission believes that if a trust is governed by U.S. law (*i.e.*, the law of a state or other jurisdiction in the United States), then it would generally be reasonable to treat the trust as a U.S. person for purposes of the Proposed Rule. Another relevant element in this regard would be whether a court within the United States is able to exercise primary supervision over the administration of the trust. The Commission expects that this aspect of the definition would generally align the treatment of the trust for purposes of the Proposed Rule with how the trust is treated for other legal purposes. For example, the Commission expects that if a person could bring suit against the trustee for breach of fiduciary duty in a U.S. court (and, as noted above, the trust is governed by U.S. law), then treating the trust as a U.S. person would generally be consistent with its treatment for other purposes.

As noted in the Cross-Border Margin Rule,[87] and consistent with the SEC[88] definition of "U.S. person," proposed § 23.23(a)(22)(ii) provides that the principal place of business means the location from which the officers, partners, or managers of the legal person primarily direct, control, and coordinate the activities of the legal person. With the exception of externally managed entities, as discussed below, the Commission is of the view that for most entities, the location of these officers, partners, or managers generally would correspond to the location of the person's headquarters or main office. However, the Commission believes that a definition that focuses exclusively on whether

[87] Cross-Border Margin Rule, 81 FR at 34823.
[88] 17 CFR 240.3a71-3(a)(4)(ii).

a legal person is organized, incorporated, or established in the United States could encourage some entities to move their place of incorporation to a non-U.S. jurisdiction to avoid complying with the relevant Dodd-Frank Act requirements, while maintaining their principal place of business – and therefore, risks arising from their swap transactions – in the United States. Moreover, a "U.S. person" definition that does not include a "principal place of business" element could result in certain entities falling outside the scope of the relevant Dodd-Frank Act-related requirements, even though the nature of their legal and financial relationships in the United States is, as a general matter, indistinguishable from that of entities incorporated, organized, or established in the United States. Therefore, the Commission is of the view that it is appropriate to treat such entities as U.S. persons for purposes of the Proposed Rule.[89]

However, determining the principal place of business of a collective investment vehicle ("CIV"), such as an investment fund or commodity pool, may require consideration of additional factors beyond those applicable to operating companies. The Commission is of the view that with respect to an externally managed investment vehicle, this location is the office from which the manager of the vehicle primarily directs, controls, and coordinates the investment activities of the vehicle.[90] This interpretation is consistent with the Supreme Court's decision in *Hertz Corp. v. Friend*, which described a corporation's principal place of business, for purposes of diversity jurisdiction, as the "place where the corporation's high level officers direct, control, and coordinate the

[89] *See* SEC Cross-Border Rule, 79 FR at 47309.
[90] Proposed § 23.23(a)(22)(ii).

corporation's activities."[91] In the case of a CIV, the senior personnel that direct, control, and coordinate a CIV's activities are generally not the named directors or officers of the CIV, but rather persons employed by the CIV's investment advisor or promoter, or in the case of a commodity pool, its commodity pool operator. Therefore, consistent with the SEC Cross-Border Rule,[92] when a primary manager is responsible for directing, controlling, and coordinating the overall activity of a CIV, the CIV's principal place of business under the proposed rule would be the location from which the manager carries out those responsibilities.

The Commission notes that under the Cross-Border Margin Rule,[93] the Commission would generally consider the principal place of business of a CIV to be in the United States if the senior personnel responsible for either: (1) the formation and promotion of the CIV; or (2) the implementation of the CIV's investment strategy are located in the United States, depending on the facts and circumstances that are relevant to determining the center of direction, control, and coordination of the CIV. Although the second prong of that discussion is consistent with the approach discussed above, the Commission does not believe that activities such as formation of the CIV, absent an ongoing role by the person performing those activities in directing, controlling, and coordinating the investment activities of the CIV, generally will be as indicative of activities, financial and legal relationships, and risks within the United States of the type that Title VII is intended to address as the location of a CIV manager.

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[91] *See* 559 U.S. 77, 80 (2010); Cross-Border Margin Rule, 81 FR at 34823.
[92] *See* SEC Cross-Border Rule, 79 FR at 47310-11.
[93] *See* Cross-Border Margin Rule, 81 FR at 34823. This is also generally consistent with the views expressed in the Guidance. *See* Guidance, 78 FR at 45309-12.

With respect to proposed § 23.23(a)(22)(i)(*4*), the Commission believes that the swaps of a decedent's estate should generally be treated the same as the swaps entered into by the decedent during their life.[94] If the decedent was a party to any swaps at the time of death, then those swaps should generally continue to be treated in the same way after the decedent's death, at which time the swaps would most likely pass to the decedent's estate. Also, the Commission expects that this prong will be predictable and straightforward to apply for natural persons planning for how their swaps will be treated after death, for executors and administrators of estates, and for the swap counterparties to natural persons and estates.

Proposed § 23.23(a)(22)(i)(*3*) is intended to ensure that persons described in prongs (*1*), (*2*), and (*4*) of the definition would be treated as U.S. persons even if they use discretionary or non-discretionary accounts to enter into swaps, irrespective of whether the person at which the account is held or maintained is a U.S. person. Consistent with the Cross-Border Margin Rule, the Commission is of the view that this prong would apply for individual or joint accounts.[95]

Unlike the Cross-Border Margin Rule, the proposed definition of "U.S. person" would not include certain legal entities that are owned by one or more U.S. person(s) and for which such person(s) bear unlimited responsibility for the obligations and liabilities of the legal entity ("unlimited U.S. responsibility prong").[96] This prong was designed to

[94] The Commission expects that relatively few estates would enter into swaps, and those that do would likely do so for hedging purposes.
[95] *See* 17 CFR 23.160(a)(10)(vii).
[96] *See* 17 CFR 23.160(a)(10)(vi); Cross-Border Margin Rule, 81 FR at 34823-24. The Guidance included a similar concept in the definition of the term "U.S. person." However, the definition contained in the Guidance would generally characterize a legal entity as a U.S. person if the entity were "directly or

capture persons that could give rise to risk to the U.S. financial system in the same manner as with non-U.S. persons whose swap transactions are subject to explicit financial support arrangements from U.S. persons. Rather than including this prong in its "U.S. person" definition, the SEC took the view that when a non-U.S. person's counterparty has recourse to a U.S. person for the performance of the non-U.S. person's obligations under a security-based swap by virtue of the U.S. person's unlimited responsibility for the non-U.S. person, the non-U.S. person would be required to include the security-based swap in its security-based swap dealer (if it is a dealing security-based swap) and major security-based swap participant threshold calculations as a guarantee.[97] However, as discussed in the Cross-Border Margin Rule, the Commission does not view the unlimited U.S. responsibility prong as equivalent to a U.S. guarantee because a guarantee does not necessarily provide for unlimited responsibility for the obligations and liabilities of the guaranteed entity in the same sense that the owner of an unlimited liability corporation bears such unlimited liability.[98]

The Commission is declining at this time to revisit its interpretation of "guarantee," discussed below, and is not including an "unlimited U.S. responsibility prong" in the "U.S. person" definition in the Proposed Rule. The Commission is of the view that the corporate structure that this prong is designed to capture is not one that is commonly in use in the marketplace. As noted below, the Commission requests

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indirectly majority-owned" by one or more persons falling within the term ''U.S. person'' and such U.S. person(s) bears unlimited responsibility for the obligations and liabilities of the legal entity. *See* Guidance, 78 FR at 45312-13 (discussing the unlimited U.S. responsibility prong for purposes of the Guidance).

[97] *See* SEC Cross-Border Rule, 79 FR at 47308 n.255, 47316-17.

[98] *See* Cross-Border Margin Rule, 81 FR at 34823 n.60.

comments on whether this understanding is correct, and if not, whether the Commission should add this prong to the proposed "U.S. person" definition or reassess its proposed interpretation of a "guarantee." In addition, the Commission notes that the treatment of the unlimited U.S. liability prong in the Proposed Rule would not impact an entity's obligations with respect to the Cross-Border Margin Rule. To the extent that entities are considered U.S. persons for purposes of the Cross-Border Margin Rule as a result of the unlimited U.S. liability prong, the Commission believes that the different purpose of the registration-related rules justifies this potentially different treatment.

The proposed "U.S. person" definition is generally consistent with the "U.S. person" interpretation set forth in the Guidance, with certain exceptions.[99] As noted above,[100] the Cross-Border Margin Rule and the Guidance incorporated a version of the unlimited U.S. responsibility prong in the U.S. person definition. In addition, consistent with the definition of "U.S. person" in the Cross-Border Margin Rule[101] and the SEC Cross-Border Rule,[102] the proposed definition does not include a commodity pool, pooled account, investment fund, or other CIV that is majority-owned by one or more U.S. persons.[103] Similar to the SEC, the Commission is of the view that including majority-owned CIVs within the definition of "U.S. person" for the purposes of the Proposed Rule would be likely to cause more CIVs to incur additional programmatic costs associated

[99] *See* Guidance, 78 FR at 45308-17 (setting forth the interpretation of "U.S. person" for purposes of the Guidance).
[100] *See supra* note 96.
[101] *See* Cross-Border Margin Rule, 81 FR at 34824.
[102] *See* SEC Cross-Border Rule, 79 FR at 47311, 47337.
[103] *See* Guidance, 78 FR at 45313-14 (discussing the U.S. majority-ownership prong for purposes of the Guidance and interpreting "majority-owned" in this context to mean the beneficial ownership of more than 50 percent of the equity or voting interests in the collective investment vehicle).

with the relevant Title VII requirements and ongoing assessments, while not significantly increasing programmatic benefits given that the composition of a CIV's beneficial owners is not likely to have significant bearing on the degree of risk that the CIV's swap activity poses to the U.S. financial system.[104] Although many of these CIVs have U.S. participants that could be adversely impacted in the event of a counterparty default, systemic risk concerns are mitigated to the extent these collective investment vehicles would be subject to margin requirements in foreign jurisdictions. In addition, the exposure of participants to losses in CIVs is typically limited to their investment amount, and it is unlikely that a participant in a CIV would make counterparties whole in the event of a default.[105] Further, the Commission continues to believe that identifying and tracking a CIV's beneficial ownership may pose a significant challenge in certain circumstances (*e.g.*, fund-of-funds or master-feeder structures).[106] Therefore, although the U.S. participants in such CIVs may be adversely impacted in the event of a counterparty default, the Commission believes that, on balance, the majority-ownership test should not be included in the proposed definition of U.S. person. Note that a CIV fitting within the majority U.S. ownership prong may also be a U.S. person within the scope of § 23.23(a)(22)(i)(*2*) of the Proposed Rule (entities organized or having a principal place of business in the United States). As the Commission clarified in the Cross-Border Margin Rule, whether a pool, fund, or other CIV is publicly offered only to

[104] *See* SEC Cross-Border Rule, 79 FR at 47337.
[105] *See id.* at 47311.
[106] *See* Cross-Border Margin Rule, 81 FR at 34824.

non-U.S. persons and not offered to U.S. persons would not be relevant in determining whether it falls within the scope of the proposed U.S. person definition.[107]

Unlike the non-exhaustive "U.S. person" definition provided in the Guidance, the proposed definition of "U.S. person" is limited to persons enumerated in the rule, consistent with the Cross-Border Margin Rule and the SEC Cross-Border Rule.[108] The Commission believes that the proposed prongs discussed above would capture those persons with sufficient jurisdictional nexus to the financial system and commerce in the United States that they should be categorized as "U.S. persons" pursuant to the Proposed Rule.

Further, in consideration of the discretionary and appropriate exercise of international comity-based doctrines, proposed § 23.23(a)(22)(iii) states that the term "U.S. person" would not include international financial institutions, as defined below. Specifically, consistent with the SEC's definition,[109] the term U.S. person would not include the International Monetary Fund, the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the United Nations, and their agencies and pension plans, and any other similar international organizations, their agencies, and pension plans. The Commission believes that although foreign entities are not necessarily immune from U.S. jurisdiction for commercial activities undertaken with U.S. counterparties or in U.S. markets, the sovereign or international status of such international financial institutions

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[107] *See id.* at 81 FR at 34824 n.62.
[108] *See* Cross-Border Margin Rule, 81 FR at 34824; Guidance, 78 FR at 45316 (discussing the inclusion of the prefatory phrase "include, but not be limited to" in the interpretation of "U.S. person" in the Guidance).
[109] 17 CFR 240.3a71-3(a)(4)(iii).

that themselves participate in the swap markets in a commercial manner is relevant in determining whether such entities should be treated as U.S. persons, regardless of whether any of the prongs of the proposed definition would apply.[110] There is nothing in the text or history of the swap-related provisions of Title VII to suggest that Congress intended to deviate from the traditions of the international system by including such international financial institutions within the definitions of the term "U.S. person."[111]

Consistent with the Entities Rule and the Guidance, the Commission is of the view that the term "international financial institutions" includes the "international financial institutions" that are defined in 22 U.S.C. 262r(c)(2) and institutions defined as "multilateral development banks" in the European Union's regulation on "OTC derivatives, central counterparties and trade repositories."[112] Reference to 22 U.S.C. 262r(c)(2) and the European Union definition is consistent with Commission precedent in

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[110] *See, e.g.*, Entities Rule, 77 FR at 30692-93 (discussing the application of the "swap dealer" and "major swap participant" definitions to foreign governments, foreign central banks, and international financial institutions). The Commission also notes that a similar approach was taken in the Guidance. Guidance, 78 FR at 45353 n.531 ("Where the counterparty to a non-U.S. swap dealer or non-U.S. MSP is an international financial institution such as the World Bank, the Commission also generally would not expect the parties to the swap to comply with the Category A Transaction-Level Requirements, even if the principal place of business of the international financial institution were located in the United States. . . . . Even though some or all of these international financial institutions may have their principal place of business in the United States, the Commission would generally not consider the application of the Category A Transaction-Level Requirements to be warranted, for the reasons of the traditions of the international system discussed in the [Entities Rule].").

[111] To the contrary, section 752(a) of the Dodd-Frank Act requires the CFTC to consult and coordinate with other regulators on the establishment of consistent international standards with respect to the regulation (including fees) of swaps and swap entities.

[112] Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC Derivative Transactions, Central Counterparties and Trade Repositories, Article 1(5(a)) (July 4, 2012), available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32012R0648. Article 1(5(a)) references Section 4.2 of Part 1 of Annex VI to Directive 2006/48/EC, available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32006L0048.

the Entities Rule.[113] The Commission continues to believe that both of those definitions identify many of the entities for which discretionary and appropriate exercise of international comity-based doctrines is appropriate with respect to the "U.S. person" definition.[114] The Commission is of the view that this prong would also include institutions identified in CFTC Staff Letters 17-34[115] and 18-13.[116] In CFTC Staff Letter 17-34, Commission staff provided relief from CFTC margin requirements to swaps between SDs and the European Stability Mechanism ("ESM"),[117] and in CFTC Staff Letter 18-13, Commission staff identified the North American Development Bank ("NADB") as an additional entity that should be considered an international financial

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[113] Entities Rule, 77 FR at 30692, n.1180. Additionally, the Commission notes that the Guidance referenced the Entities Rule's interpretation as well. Guidance, 78 FR at 45353 n.531.

[114] The definitions overlap but together include the following: The International Monetary Fund, International Bank for Reconstruction and Development, European Bank for Reconstruction and Development, International Development Association, International Finance Corporation, Multilateral Investment Guarantee Agency, African Development Bank, African Development Fund, Asian Development Bank, Inter-American Development Bank, Bank for Economic Cooperation and Development in the Middle East and North Africa, Inter-American Investment Corporation, Council of Europe Development Bank, Nordic Investment Bank, Caribbean Development Bank, European Investment Bank and European Investment Fund. Note that the International Bank for Reconstruction and Development, the International Development Association, the International Finance Corporation, and the Multilateral Investment Guarantee Agency are parts of the World Bank Group.

[115] *See* CFTC Staff Letter No. 17-34, Commission Regulations 23.150-159, 161: No-Action Position with Respect to Uncleared Swaps with the European Stability Mechanism (Jul, 24, 2017), available at https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/17-34.pdf. *See also* CFTC Staff Letter No. 19-22, Commission Regulations 23.150-159, 23.161: Revised No-Action Position with Respect to Uncleared Swaps with the European Stability Mechanism (Oct. 16, 2019), available at https://www.cftc.gov/csl/19-22/download.

[116] *See* CFTC Staff Letter No. 18-13, No-Action Position: Relief for Certain Non-U.S. Persons from Including Swaps with International Financial Institutions in Determining Swap Dealer and Major Swap Participant Status (May 16, 2018), available at https://www.cftc.gov/sites/default/files/csl/pdfs/18/18-13.pdf.

[117] *See* CFTC Staff Letter No. 17-34. In addition, in October 2019, the Commission approved a proposal to exclude ESM from the definition of "financial end user" in § 23.151, which, if adopted, would have the effect of excluding swaps between certain SDs and ESM from the Commission's uncleared swap margin requirements. *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 84 FR 56392 (Oct. 22, 2019).

institution for purposes of applying the SD and MSP definitions.[118] Interpreting the definition to include the two entities identified in CFTC Staff Letters 17-34 and 18-13 is consistent with the discretionary and appropriate exercise of international comity because the status of both entities is similar to that of the other international financial institutions identified in the Entities Rule. Consistent with the SEC definition of "U.S. person," the Proposed Rule lists specific international financial institutions but also provides a catch-all for "any other similar international organizations, their agencies, and pension plans." The Commission believes that the catch-all provision would extend to any of the specific entities discussed above that are not explicitly listed in the Proposed Rule.

As described above, the Commission is of the view that the proposed "U.S. person" definition is largely similar to the definition in the Cross-Border Margin Rule. Specifically, the Commission believes that any person designated as a "U.S. person" under the Proposed Rule would also be designated as such under the Cross-Border Margin Rule. Therefore, the Commission believes any inconsistencies do not raise significant concerns regarding the practical application of the "U.S. person" definitions. Further, the Commission believes that having a definition that is harmonized with the SEC allows for more efficient application of the definitions by market participants, including entities that may engage in dealing activity with respect to both swaps and security-based swaps. Therefore, the Commission may also consider amending the "U.S. person" definition in the Cross-Border Margin Rule in the future. However, to provide

[118] *See* CFTC Staff Letter 18-13. *See also* CFTC Staff Letter 17-59 (Nov. 17, 2017) (providing no-action relief to NADB from the swap clearing requirement of section 2(h)(1) of the CEA), available at https://www.cftc.gov/idc/groups/public/%40lrlettergeneral/documents/letter/17-59.pdf.

certainty to market participants, proposed § 23.23(a)(22)(iv) would permit reliance, until December 31, 2025, on any U.S. person-related representations that were obtained to comply with the Cross-Border Margin Rule. This time-limited relief is appropriate so that market participants do not have to immediately obtain new representations from their counterparties. The Commission also believes that any person designated as a "U.S. person" under the Proposed Rule would also be a "U.S. person" under the Guidance definition, since the Proposed Rule's definition is narrower in scope. Therefore, the Commission is of the view that market participants would also be able to rely on representations previously obtained using the "U.S. person" definition in the Guidance.

The term "non-U.S. person" would be defined to mean any person that is not a U.S. person.[119] Further, the Proposed Rule would define "United States" and "U.S." as the United States of America, its territories and possessions, any State of the United States, and the District of Columbia.[120]

B. Guarantee

Under the Proposed Rule, consistent with the Cross-Border Margin Rule,[121] a "guarantee" would mean an arrangement, pursuant to which one party to a swap has rights of recourse against a guarantor, with respect to its counterparty's obligations under the swap.[122] For these purposes, a party to a swap has rights of recourse against a guarantor if the party has a conditional or unconditional legally enforceable right to

[119] Proposed § 23.23(a)(9).
[120] Proposed § 23.23(a)(19).
[121] *See* 17 CFR 23.160(a)(2). However, in contrast with the Cross-Border Margin Rule, the application of the proposed definition of "guarantee" would not be limited to uncleared swaps.
[122] Proposed § 23.23(a)(8).

receive or otherwise collect, in whole or in part, payments from the guarantor with respect to its counterparty's obligations under the swap. Also, the term "guarantee" would encompass any arrangement pursuant to which the guarantor itself has a conditional or unconditional legally enforceable right to receive or otherwise collect, in whole or in part, payments from any other guarantor with respect to the counterparty's obligations under the swap.

Consistent with the Cross-Border Margin Rule, the proposed term "guarantee" would apply regardless of whether such right of recourse is conditioned upon the non-U.S. person's insolvency or failure to meet its obligations under the relevant swap, and regardless of whether the counterparty seeking to enforce the guarantee is required to make a demand for payment or performance from the non-U.S. person before proceeding against the U.S. guarantor.[123] The terms of the guarantee need not necessarily be included within the swap documentation or even otherwise reduced to writing (so long as legally enforceable rights are created under the laws of the relevant jurisdiction), provided that a swap counterparty has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, the U.S. person in connection with the non-U.S. person's obligations under the swap. For purposes of the Proposed Rule, the Commission would generally consider swap activities involving guarantees from U.S. persons to satisfy the "direct and significant" test under CEA section 2(i).

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[123] *See* 17 CFR 23.160(a)(2); Cross-Border Margin Rule, 81 FR at 34825.

The proposed term "guarantee" would also encompass any arrangement pursuant to which the counterparty to the swap has rights of recourse, regardless of the form of the arrangement, against at least one U.S. person (either individually, jointly, and/or severally with others) for the non-U.S. person's obligations under the swap.[124] This addresses concerns that swaps could be structured such that they would not have to count toward a non-U.S. person's de minimis threshold calculation. For example, consider a swap between two non-U.S. persons ("Party A" and "Party B"), where Party B's obligations to Party A under the swap are guaranteed by a non-U.S. affiliate ("Party C"), and where Party C's obligations under the guarantee are further guaranteed by a U.S. parent entity ("Parent D"). The proposed definition of "guarantee" would deem a guarantee to exist between Party B and Parent D with respect to Party B's obligations under the swap with Party A.[125]

Further, the Commission's proposed definition of guarantee would not be affected by whether the U.S. guarantor is an affiliate of the non-U.S. person because, in each case, regardless of affiliation, the swap counterparty has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, the U.S. person in connection with the non-U.S. person's obligations.

The Commission also notes that the proposed "guarantee" definition would not apply when a non-U.S. person has a right to be compensated by a U.S. person with respect to the non-U.S. person's own obligations under the swap. For example, consider

[124] *See* Cross-Border Margin Rule, 81 FR at 34825.
[125] *See id.* This example is included for illustrative purposes only and is not intended to cover all examples of swaps that could be affected by the Proposed Rule, if adopted.

a swap between two non-U.S. persons ("Party E" and "Party F"), where Party E enters into a back-to-back swap with a U.S. person ("Party G"), or enters into an agreement with Party G to be compensated for any payments made by Party E under the swap in return for passing along any payments received. In such an arrangement, a guarantee would not exist because Party F would not have a right to collect payments from Party G with respect to Party E's obligations under the swap (assuming no other agreements exist).

As with the Cross-Border Margin Rule, the definition of "guarantee" in the Proposed Rule is narrower in scope than the one used in the Guidance.[126] Under the Guidance, the Commission advised that it would interpret the term "guarantee" generally to include not only traditional guarantees of payment or performance of the related swaps, but also other formal arrangements that, in view of all the facts and circumstances, support the non-U.S. person's ability to pay or perform its swap obligations. The Commission stated that it believed that it was necessary to interpret the term "guarantee" to include the different financial arrangements and structures that transfer risk directly back to the United States.[127] The Commission is aware that many other types of financial arrangements or support, other than a guarantee as defined in the Proposed Rule, may be provided by a U.S. person to a non-U.S. person (*e.g.*, keepwells and liquidity puts, certain types of indemnity agreements, master trust agreements, liability or loss transfer or sharing agreements). The Commission understands that these other financial arrangements or support transfer risk directly back to the U.S. financial system, with possible significant adverse effects, in a manner similar to a guarantee with a direct

[126] *See id.* at 34824.
[127] Guidance, 78 FR at 45320.

recourse to a U.S. person. However, the Commission believes that a narrower definition of guarantee than that in the Guidance would achieve a more workable framework for non-U.S. persons, particularly because this definition of "guarantee" would be consistent with the Cross-Border Margin Rule, and therefore would not require a separate independent assessment, without undermining the protection of U.S. persons and the U.S. financial system. The Commission recognizes that the proposed definition of "guarantee" could, if adopted, lead to certain entities counting fewer swaps towards their de minimis threshold as compared to the definition in the Guidance. However, the Commission believes that concerns arising from fewer swaps being counted could be mitigated to the extent such non-U.S. person meets the definition of a "significant risk subsidiary," and thus, as discussed below, would potentially still need to count certain swaps or swap positions toward its SD or MSP registration threshold. In this way, non-U.S. persons receiving support from a U.S. person and representing some measure of material risk to the U.S. financial system would be captured. The Commission thus believes that the Proposed Rule would achieve the dual goals of protecting the U.S. markets while promoting a workable cross-border framework.

For discussion purposes in this release, a non-U.S. person would be considered a "Guaranteed Entity" with respect to swaps that are guaranteed by a U.S. person. A non-U.S. person may be a Guaranteed Entity with respect to swaps with certain counterparties because the non-U.S. person's swaps with those counterparties are guaranteed, but would not be a Guaranteed Entity with respect to swaps with other counterparties if the non-U.S. person's swaps with the other counterparties are not guaranteed by a U.S. person. In other words, depending on the nature of the trading relationship, a single entity could be a Guaranteed Entity with respect to some of its swaps, but not others. This release uses the term "Other Non-U.S. Person" to refer to a non-U.S. person that is neither a Guaranteed Entity nor a significant risk subsidiary. Depending on an entity's corporate structure and financial relationships, a single entity could be both, for example, a Guaranteed Entity and an Other Non-U.S. Person.

C. Significant Risk Subsidiary, Significant Subsidiary, Subsidiary, Parent Entity, and U.S. GAAP

In the Proposed Rule, the Commission is proposing a new category of person termed a significant risk subsidiary ("SRS"). A non-U.S. person would be considered an SRS if: (1) the non-U.S. person is a "significant subsidiary" of an "ultimate U.S. parent entity," as those terms are proposed to be defined; (2) the "ultimate U.S. parent entity" has more than $50 billion in global consolidated assets, as determined in accordance with U.S. GAAP at the end of the most recently completed fiscal year; and (3) the non-U.S. person is not subject to either: (a) consolidated supervision and regulation by the Board of Governors of the Federal Reserve System ("Federal Reserve Board") as a subsidiary of a U.S. bank holding company ("BHC"); or (b) capital standards and oversight by the non-U.S. person's home country regulator that are consistent with the Basel Committee on Banking Supervision's "International Regulatory Framework for Banks" ("Basel III") and margin requirements for uncleared swaps in a jurisdiction for which the Commission has issued a comparability determination ("CFTC Margin Determination") with respect to uncleared swap margin requirements.[128] If an entity is determined to be an SRS, the Commission proposes to apply certain regulations, including the SD and MSP registration threshold calculations, to the entity in the same manner as a U.S. person.

1. Non-U.S. Persons with U.S. Parent Entities

In addition to the U.S. persons described above in section II.A, the Commission understands that U.S. persons may organize the operations of their businesses through the use of one or more subsidiaries that are organized and operated outside the United States. Through consolidation, non-U.S. subsidiaries of U.S. persons may permit U.S. persons to accrue risk through the swap activities of their non-U.S. subsidiaries that, in aggregate, may have a significant effect on the U.S. financial system. Therefore, the Commission believes that consolidated non-U.S. subsidiaries of U.S. persons may appropriately be subject to Commission regulation due to their direct and significant relationship to their U.S. parent entities. Thus, the Commission believes that consolidated non-U.S. subsidiaries of U.S. parent entities present a greater supervisory interest to the CFTC, relative to Other Non-U.S. Persons. Moreover, because U.S. persons have regulatory obligations under the CEA that Other Non-U.S. Persons may not have, the Commission also believes that consolidated non-U.S. subsidiaries of U.S. parent entities present a greater supervisory interest to the CFTC relative to Other Non-U.S. Persons due to the Commission's interest in preventing the evasion of obligations under the CEA.

Pursuant to the consolidation requirements of U.S. GAAP, the financial statements of a U.S. parent entity reflect the financial position and results of operations of

[128] Proposed § 23.23(a)(11)-(14) and (18).

that parent entity, together with the network of branches and subsidiaries in which the U.S. parent entity has a controlling interest, including non-U.S. subsidiaries, which is an indication of connection and potential risk to the U.S. parent entity. Consolidation under U.S. GAAP is predicated on the financial control of the reporting entity. Therefore, an entity within a financial group that is consolidated with its parent entity for accounting purposes in accordance with U.S. GAAP is subject to the financial control of that parent entity. By virtue of consolidation then, a non-U.S. subsidiary's swap activity creates direct risk to the U.S. parent. That is, as a result of consolidation and financial control, the financial position, operating results, and statement of cash flows of a non-U.S. subsidiary are included in the financial statements of its U.S. parent and therefore affect the financial condition, risk profile, and market value of the parent. Because of that relationship, risks taken by a non-U.S. subsidiary can have a direct effect on the U.S. parent entity. Furthermore, a non-U.S. subsidiary's counterparties may generally look to both the subsidiary and its U.S. parent for fulfillment of the subsidiary's obligations under a swap, even without any explicit guarantee. In many cases, the Commission believes that counterparties would not enter into the transaction with the subsidiary (or would not do so on the same terms), and the subsidiary would not be able to engage in a swap business, absent this close relationship with a parent entity. In addition, the Commission notes that a non-U.S. subsidiary may enter into offsetting swaps or other arrangements with its U.S. parent entity or other affiliate(s) to transfer the risks and benefits of swaps with non-U.S. persons to its U.S. affiliates, which could also lead to risk for the U.S. parent entity. Because such swap activities may have a direct impact on the financial position, risk profile, and market value of a U.S. parent entity, they can lead to spill-over effects on the U.S. financial system.

However, the Commission preliminarily believes the principles of international comity counsel against applying its swap regulations to all non-U.S. subsidiaries of U.S. parent entities. Rather, the Commission believes that it is consistent with such principles to apply a risk-based approach to determining which of such entities should be required to comply with the Commission's swap requirements. The Commission believes that its approach in the Proposed Rule makes that determination in a manner that accounts for the risk that non-U.S. subsidiaries may pose to the U.S. financial system and the ability of large global entities to efficiently operate outside the United States.

The Commission's risk-based approach is embodied in the proposed definition of an SRS. SRSs are entities whose obligations under swaps may not be guaranteed by U.S. persons, but which nonetheless raise particular supervisory concerns in the United States due to the possible negative impact on their ultimate U.S. parent entities and thus the U.S. financial system.

2. Preliminary Definitions

For purposes of the SRS definition, the term "subsidiary" would mean a subsidiary of a specified person that is an affiliate controlled by such person directly, or indirectly through one or more intermediaries.[129] For purposes of this definition, an affiliate of, or a person affiliated with, a specific person would be a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under

[129] Proposed § 23.23(a)(14).

common control with, the person specified. The term "control," including controlling, controlled by, and under common control with, would mean the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting shares, by contract, or otherwise.[130] These proposed definitions of subsidiary and control are substantially similar to the definitions found in SEC regulation S-X. Further, under the Proposed Rule, the term "parent entity" would mean any entity in a consolidated group that has one or more subsidiaries in which the entity has a controlling interest, in accordance with U.S. GAAP.[131] U.S. GAAP is defined in the Proposed Rule as U.S. generally accepted accounting principles.[132]

Notably, a U.S. parent entity for purposes of the definition of SRS need not be a non-U.S. subsidiary's ultimate parent entity. The SRS definition would encompass U.S. parent entities that may be intermediate entities in a consolidated corporate family with an ultimate parent entity located outside the U.S. To differentiate between multiple possible U.S. parent entities, the Proposed Rule defines an "ultimate U.S. parent entity" for purposes of the significant subsidiary test. A non-U.S. person's "ultimate U.S. parent entity" would be the U.S. parent entity that is not a subsidiary of any other U.S. parent entity.[133] Risk of a non-U.S. subsidiary that flows to its U.S. parent entity may not flow back out of the U.S. to a non-U.S. ultimate or intermediate parent entity. Because the risk may ultimately stop in the United States, it is appropriate for the Commission to base

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[130] Proposed § 23.23(a)(1).
[131] Proposed § 23.23(a)(11).
[132] Proposed § 23.23(a)(21).
[133] Proposed § 23.23(a)(18).

its SRS definition on whether a non-U.S. person has any U.S. parent entity, subject to certain risk-based thresholds.

3. Significant Risk Subsidiaries

In addition to the definitions discussed above, whether an entity would be considered an SRS depends on the size of its ultimate U.S. parent entity, the significance of the subsidiary to its ultimate U.S. parent entity, and the regulatory oversight of its ultimate U.S. parent entity or the regulatory oversight of the non-U.S. subsidiary in the jurisdiction in which it is regulated.

Under the Proposed Rule, the ultimate U.S. parent entity must exceed a $50 billion consolidated asset threshold. The Commission is proposing the $50 billion threshold in order to balance the Commission's interest in adequately overseeing those non-U.S. persons that may have a significant impact on their ultimate U.S. parent entity and, by extension, the U.S. financial system, with its interest in avoiding unnecessary burdens on those non-U.S. persons that would not have such an impact. The $50 billion threshold has been used in other contexts as a measure of large, complex institutions that may have systemic impacts on the U.S. financial system. For example, the Financial Stability Oversight Council ("FSOC") initially used a $50 billion total consolidated assets quantitative test as one threshold to apply to nonbank financial entities when assessing risks to U.S. financial stability.[134] The Commission preliminarily believes that the $50

[134] *See* Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, Financial Stability Oversight Council, 77 FR 21637, 21643, 21661 (Apr. 2012). FSOC recently voted to remove the existing stage 1 quantitative metrics that included, among other metrics, the $50 billion threshold, because the metrics generated confusion among firms and members of the public and because they were not compatible with FSOC's new activities based approach to addressing risk to financial stability. *See* Authority to Require Supervision and Regulation of certain Nonbank Financial Companies

billion threshold provides an appropriate measure to limit the burden of the SRS definition to only those entities whose ultimate U.S. parent entity may pose a systemic risk to the U.S. financial system.

In addition, before a non-U.S. subsidiary of an ultimate U.S. parent entity that meets the $50 billion consolidated asset threshold would be an SRS, the subsidiary would need to constitute a significant part of its ultimate U.S. parent entity. This concept of a "significant subsidiary" borrows from the SEC's definition of "significant subsidiary" in Regulation S-X, as well as the Federal Reserve Board in its financial statement filing requirements for foreign subsidiaries of U.S. banking organizations.[135] The Commission believes it is appropriate to focus on only those subsidiaries that are significant to their ultimate U.S. parent entities, in order to capture those subsidiaries that have a significant impact on their large ultimate U.S. parent entities. In order to provide certainty to market participants as to what constitutes a significant subsidiary, the Proposed Rule includes a set of quantitative significance tests. Although not identical, the Commission notes that the SEC includes similar revenue and asset significance tests in its definition of significant subsidiary in Regulation S-X.[136] The Commission believes that, in this case, in order to determine whether a subsidiary meets such significance, it is appropriate to

(Dec. 4, 2019), available at https://home.treasury.gov/system/files/261/Interpretive-Guidance-on-Nonbank-Financial-Company-Determinations.pdf. However, the Commission preliminarily believes that the $50 billion total consolidated threshold remains an appropriate and workable measure to identify those ultimate U.S. parent entities that may have a significant impact on the U.S. financial system.

[135] S*ee e.g.*, Instructions for Preparation of Financial Statements of Foreign Subsidiaries of U.S. Banking Organizations FR 2314 and FR 2314S, at GEN-2 (Sept. 2016), available at https://www.federalreserve.gov/reportforms/forms/FR_2314--FR_2314S20190331_i.pdf ("FR 2314 and FR 2314S Instructions") (identifying equity capital significance test applicable to subsidiaries). *See also* SEC rule 210.1-02(w), 17 CFR 210.1-02(w) (identifying asset and income significance tests applicable in definition of significant subsidiaries).

[136] 17 CFR 210.1-02(w)(1)-(3) (setting out a ten percent significance threshold with respect to total assets and income).

measure the significance of a subsidiary's equity capital, revenue, and assets relative to its ultimate U.S. parent entity.

Under the Proposed Rule, the term "significant subsidiary" would mean a subsidiary, including its subsidiaries, where: (1) the three year rolling average of the subsidiary's equity capital is equal to or greater than five percent of the three year rolling average of its ultimate U.S. parent entity's consolidated equity capital, as determined in accordance with U.S. GAAP at the end of the most recently completed fiscal year (the "equity capital significance test"); (2) the three year rolling average of the subsidiary's revenue is equal to or greater than ten percent of the three year rolling average of its ultimate U.S. parent entity's consolidated revenue, as determined in accordance with U.S. GAAP at the end of the most recently completed fiscal year (the "revenue significance test"); or (3) the three year rolling average of the subsidiary's assets are equal to or greater than ten percent of the three year rolling average of its ultimate U.S. parent entity's consolidated assets, as determined in accordance with U.S. GAAP at the end of the most recently completed fiscal year (the "asset significance test"). For the proposed equity capital significance test, equity capital would include perpetual preferred stock, common stock, capital surplus, retained earnings, accumulated other comprehensive income and other equity capital components and should be calculated in accordance with U.S. GAAP.

The Proposed Rule would cause an entity to be a significant subsidiary only if it passes at least one of these significance tests. The Commission preliminarily believes that the equity capital test is an appropriate measure of a subsidiary's significance to its ultimate U.S. parent entity and notes its use in the context of financial statement reporting of foreign subsidiaries.[137] The Commission also preliminarily believes that if a subsidiary constitutes more than ten percent of its ultimate U.S. parent entity's assets or revenue, it is of significant importance to its ultimate U.S. parent entity such that swap activity by the subsidiary may have a material impact on its ultimate U.S. parent entity and, consequently, the U.S. financial system. The Commission is proposing to use a three year rolling average throughout its proposed significance tests in order to mitigate the potential for an entity to frequently change from being deemed a significant subsidiary and not being deemed a significant subsidiary based on fluctuations in its share of equity capital, revenue, or assets of its ultimate U.S. parent entity. The Commission preliminarily believes that if a subsidiary satisfies any one of the three significance tests proposed here, then it is of sufficient significance to its ultimate U.S. parent entity, which under proposed § 23.23(a)(12) has consolidated assets of more than $50 billion, to warrant the application of requirements addressed by the Proposed Rule if such subsidiary otherwise meets the definition of SRS.

4. Exclusions from the Definition of SRS

As indicated above, under the Proposed Rule, a non-U.S. person would not be an SRS to the extent the entity is subject to prudential regulation as a subsidiary of a U.S. BHC or is subject to comparable capital and margin standards. An entity that meets either of those two exceptions, in the Commission's preliminary view, would be subject to a level of regulatory oversight that is sufficiently comparable to the Dodd-Frank Act

[137] FR 2314 and FR 2314S Instructions, at Gen-2.

swap regime with respect to prudential oversight. Non-U.S. subsidiaries that are part of BHCs are already subject to consolidated supervision and regulation by the Federal Reserve Board,[138] including with respect to capital and risk management requirements, and therefore their swap activity poses less risk to the financial position and risk profile of the ultimate U.S. parent entity, and thus less risk to the U.S. financial system than the swap activity of a non-U.S. subsidiary of an ultimate U.S. parent entity that is a not a BHC. In this case, the Commission preliminarily believes deference to the foreign regulatory regime would be appropriate because the swap activity is occurring within an organization that is under the umbrella of U.S. prudential regulation with certain regulatory protections already in place.[139]

Similarly, in the case of entities that are subject to capital standards and oversight by their home country regulators that are consistent with Basel III and subject to a CFTC Margin Determination, the Commission preliminarily believes that it is appropriate for the Commission to defer to the home country regulator.[140] For purposes of determining whether proposed § 23.23(a)(12)(ii) would apply, the Commission intends for persons to independently assess whether they reside in a jurisdiction that has capital standards that are consistent with Basel III.[141] In such cases where entities are subject to capital

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[138] S*ee e.g.*, Board of Governors of the Federal Reserve System, Bank Holding Company Supervision Manual, section 2100.0.1 Foreign Operations of U.S. Banking Organizations, available at https://www.federalreserve.gov/publications/files/bhc.pdf ("The Federal Reserve has broad discretionary powers to regulate the foreign activities of member banks and bank holding companies (BHCs) so that, in financing U.S. trade and investments abroad, these U.S. banking organizations can be competitive with institutions of the host country without compromising the safety and soundness of their U.S. operations."); FR 2314 and FR 2314S Instructions, at GEN 2.

[139] Proposed § 23.23(a)(12)(i).

[140] Proposed § 23.23(a)(12)(ii).

[141] Discussion regarding the Basel framework is available at https://www.bis.org/bcbs/basel3.htm.

standards and oversight by their home country regulators that are consistent with Basel III and subject to a CFTC Margin Determination, the Commission preliminarily believes that the potential risk that the entity might pose to the U.S. financial system would be adequately addressed through these capital and margin requirements. Further, such an approach is consistent with the Commission's desire to show deference to non-U.S. regulators whose requirements are comparable to the CFTC's requirements. For margin purposes, the Commission has issued a number of determinations that entities can look to in order to determine if they satisfy this aspect of the exception.[142] For capital standards and oversight consistent with Basel III, entities should look to whether the BIS has determined the jurisdiction is in compliance as of the relevant Basel Committee on Banking Supervision deadline set forth in its most recent progress report.[143] The Commission preliminarily believes that it is appropriate to except these entities from the definition of SRS, in large part, because the swaps entered into by such entities are

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[142] *See* Comparability Determination for Japan: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 63376 (Sep. 15, 2016); Comparability Determination for the European Union: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 82 FR 48394 (Oct. 13, 2017) ("Margin Comparability Determination for the European Union"); Amendment to Comparability Determination for Japan: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 84 FR 12074 (Apr. 1, 2019); and Comparability Determination for Australia: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 84 FR 12908 (Apr. 3, 2019). Further, on April 5, 2019, DSIO and the Division of Market Oversight issued a letter jointly to provide time-limited no-action relief in connection with, among other things, the Margin Comparability Determination for the European Union, in order to account for the anticipated withdrawal of the United Kingdom from the European Union. *See* CFTC Staff Letter 19-08, No-Action Relief in Connection With Certain Previously Granted Commission Determinations and Exemptions, in Order to Account for the Anticipated Withdrawal of the United Kingdom From the European Union (Apr. 5, 2019), available at https://www.cftc.gov/csl/19-08/download.

[143] The most current report was issued in October 2019. Basel Committee on Banking Supervision, Seventeenth progress report on adoption of the Basel regulatory framework (October 2019), available at https://www.bis.org/bcbs/publ/d478.pdf. Current and historical reports are available at https://www.bis.org/bcbs/implementation/rcap_reports.htm?m=3%7C14%7C656%7C59.

already subject to significant regulation, either by the Federal Reserve Board or by the entity's home country.

As noted above, if a non-U.S. subsidiary of an ultimate U.S. parent entity does not fall into either of the exceptions in proposed §§ 23.23(a)(12)(i)-(ii), the Proposed Rule would classify the subsidiary as a SRS only if its ultimate U.S. parent entity has more than $50 billion in global consolidated assets and if the subsidiary meets the definition of a significant subsidiary, set forth in proposed § 23.23(a)(13).

The Commission is requesting comment below on the proposed definitions discussed in this section.

D. Foreign Branch and Swap Conducted Through a Foreign Branch

Under the Proposed Rule, the term "foreign branch" would mean an office of a U.S. person that is a bank that: (1) is located outside the United States; (2) operates for valid business reasons; (3) maintains accounts independently of the home office and of the accounts of other foreign branches, with the profit or loss accrued at each branch determined as a separate item for each foreign branch; and (4) is engaged in the business of banking or finance and is subject to substantive regulation in banking or financing in the jurisdiction where it is located.[144]

The Commission believes that the factors listed in the proposed definition are appropriate for determining when an entity would be considered a foreign branch for

[144] Proposed § 23.23(a)(2).

purposes of the Proposed Rule.[145] The requirement that the foreign branch be located outside of the United States is consistent with the stated goal of identifying certain swap activity that is not conducted within the United States. The requirements that the foreign branch maintain accounts independent of the U.S. entity, operate for valid business reasons, and be engaged in the business of banking or finance and be subject to substantive banking or financing regulation in its non-U.S. jurisdiction are also intended to prevent evasion of the Dodd-Frank Act requirements.[146] In particular, these requirements address the concern that an entity would set up operations outside the United States in a jurisdiction without substantive banking or financial regulation to evade Dodd-Frank Act requirements and CFTC regulations.[147] The Commission notes that this proposed definition incorporates concepts from the Federal Reserve Board's Regulation K,[148] the FDIC International Banking Regulation,[149] and the Office of the Comptroller of the Currency's "foreign branch" definition.[150]

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[145] As discussed below in sections III.B.2 and IV.B.2, the Proposed Rule would not require an Other Non-U.S. Person to count toward its de minimis threshold calculations swaps conducted through a foreign branch of a registered U.S. SD.

[146] The Commission notes that national banks operating foreign branches are required under section 25 of the Federal Reserve Act ("FRA") to conduct the accounts of each foreign branch independently of the accounts of other foreign branches established by it and of its home office, and are required at the end of each fiscal period to transfer to its general ledger the profit or loss accrued at each branch as a separate item. 12 U.S.C. 604. The FRA is codified at 12 U.S.C. 221 *et seq*.

[147] As discussed below, the Commission is concerned that the material terms of a swap would be negotiated or agreed to by employees of the U.S. bank that are located in the United States and then be routed to a foreign branch so that the swap would be treated as a swap with the foreign branch for purposes of the SD and MSP registration thresholds or for purposes of certain regulatory requirements applicable to registered SDs or MSPs.

[148] Regulation K is a regulation issued by the Board of Governors of the Federal Reserve ("Federal Reserve Board") under the authority of the FRA; the Bank Holding Company Act of 1956 ("BHC Act") (12 U.S.C. 1841 *et seq.*); and the International Banking Act of 1978 ("IBA") (12 U.S.C. 3101 *et seq.*). Regulation K sets forth rules governing the international and foreign activities of U.S. banking organizations, including procedures for establishing foreign branches to engage in international banking. 12 CFR part 211. Under Regulation K, a "foreign branch" is defined as "an office of an organization (other than a representative

The proposed definition of "foreign branch" is also consistent with the SEC's approach, which, for purposes of security-based swap dealer regulation, defined foreign branch as any branch of a U.S. bank that: (1) is located outside the United States; (2) operates for valid business reasons; and (3) is engaged in the business of banking and is subject to substantive banking regulation in the jurisdiction where located.[151] The Commission's intention is to ensure that the definition provides sufficient clarity as to what constitutes a "foreign branch" – specifically, an office outside of the U.S. that has independent accounts from the home office and other branches – while striving for greater regulatory harmony with the SEC.[152]

The Commission notes that a foreign branch would not include an affiliate of a U.S. bank that is incorporated or organized as a separate legal entity.[153] For similar reasons, the Commission declines in the Proposed Rule to recognize foreign branches of

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office) that is located outside the country in which the organization is legally established and at which a banking or financing business is conducted." 12 CFR 211.2(k).

[149] 12 CFR part 347 is a regulation issued by the Federal Deposit Insurance Corporation under the authority of the Federal Deposit Insurance Act (12 U.S.C. 1828(d)(2)), which sets forth rules governing the operation of foreign branches of insured state nonmember banks ("FDIC International Banking Regulation"). Under 12 CFR 347.102(j), a "foreign branch" is defined as an office or place of business located outside the United States, its territories, Puerto Rico, Guam, American Samoa, the Trust Territory of the Pacific Islands, or the Virgin Islands, at which banking operations are conducted, but does not include a representative office.

[150] 12 CFR 28.2 (defining "foreign branch" as an office of a national bank (other than a representative office) that is located outside the United States at which banking or financing business is conducted).

[151] *See* 17 CFR 240.3a71-3(a)(2).

[152] The Commission also notes that the factors listed in the Proposed Rule are similar to the approach described in the Guidance, which stated that the foreign branch of a U.S. swap entity is an entity that is: (1) subject to Regulation K or the FDIC International Banking Regulation, or otherwise designated as a "foreign branch" by the U.S. bank's primary regulator; (2) maintains accounts independently of the home office and of the accounts of other foreign branches with the profit or loss accrued at each branch determined as a separate item for each foreign branch; and (3) subject to substantive regulation in banking or financing in the jurisdiction where it is located. *See* Guidance, 78 FR at 45329.

[153] This is similar to the approach described in the Guidance. *See* Guidance, 78 FR at 45328-29.

U.S. persons separately from their U.S. principal for purposes of registration.[154] That is, if the foreign branch engages in swap activity in excess of the relevant SD or MSP registration thresholds, as discussed further below, the U.S. person would be required to register, and the registration would encompass the foreign branch. However, upon consideration of principles of international comity and the factors set forth in the Restatement, rather than broadly excluding foreign branches from the U.S. person definition, the Commission is proposing to calibrate the requirements for counting certain swaps entered into through a foreign branch, as described in sections III.B.2 and IV.B.2, and proposing to calibrate the requirements otherwise applicable to foreign branches of a registered U.S. SD, as discussed in section VI. Among the benefits, as discussed below, would be to enable foreign branches of U.S. banks to have greater access to foreign markets.

Under the Proposed Rule, the term "swap conducted through a foreign branch" would mean a swap entered into by a foreign branch where: (1) the foreign branch or another foreign branch is the office through which the U.S. person makes and receives payments and deliveries under the swap pursuant to a master netting or similar trading agreement, and the documentation of the swap specifies that the office for the U.S. person is such foreign branch; (2) the swap is entered into by such foreign branch in its normal course of business; and (3) the swap is reflected in the local accounts of the foreign branch.[155]

[154] This is similar to the approach described in the Guidance. *See id.* at 45315, 45328-29.
[155] Proposed § 23.23(a)(16).

The Commission believes that this definition identifies the type of swap activity for which the foreign branch performs key dealing functions outside the United States. Because a foreign branch of a U.S. bank is not a separate legal entity, the first prong of the definition clarifies that the foreign branch must be the office of the U.S. bank through which payments and deliveries under the swap must be made. This approach is consistent with the standard ISDA Master Agreement, which requires that each party specify an "office" for each swap, which is where a party "books" a swap and/or the office through which the party makes and receives payments and deliveries.[156]

The second prong of the definition (whether the swap is entered into by such foreign branch in the normal course of business) is intended as an anti-evasion measure to prevent a U.S. bank from simply routing swaps for booking in a foreign branch so that the swap would be treated as a swap conducted through a foreign branch for purposes of the SD and MSP registration thresholds or for purposes of certain regulatory requirements applicable to registered SDs or MSPs. To satisfy this prong, it must be the normal course of business for employees located in the branch (or another foreign branch of the U.S. bank) to enter into the type of swap in question. The Commission preliminarily believes that this requirement would not prevent personnel of the U.S. bank located in the U.S. from participating in the negotiation or execution of the swap so long the swaps that are booked in the foreign branch are primarily entered into by personnel located in the branch (or another foreign branch of the U.S. bank).

[156] The ISDA Master Agreement defines "office" as a branch or office of a party, which may be such party's head or home office. *See* 2002 ISDA Master Agreement, available at https://www.isda.org/book/2002-isda-master-agreement-english/library.

With respect to the third prong, the Commission believes that where a swap is with the foreign branch of a U.S. bank, it generally would be reflected in the foreign branch's accounts.[157]

E. Swap Entity, U.S. Swap Entity, and Non-U.S. Swap Entity

Under the Proposed Rule, the term "swap entity" would mean a person that is registered with the Commission as a SD or MSP pursuant to the CEA.[158] In addition, the Commission is proposing to define "U.S. swap entity" as a swap entity that is a U.S. person,[159] and "non-U.S. swap entity" as a swap entity that is not a U.S swap entity.[160]

F. U.S. Branch and Swap Conducted Through a U.S. Branch

Under the Proposed Rule, the term "U.S. branch" would mean a branch or agency of a non-U.S. banking organization where such branch or agency: (1) is located in the United States; (2) maintains accounts independently of the home office and other U.S. branches, with the profit or loss accrued at each branch determined as a separate item for each U.S. branch; and (3) engages in the business of banking and is subject to substantive banking regulation in the state or district where located.[161] The term "swap conducted through a U.S. branch" would mean a swap entered into by a U.S. branch where: (1) the U.S. branch is the office through which the non-U.S. person makes and receives

[157] This proposed definition is generally consistent with the definition under the Guidance. *See* Guidance, 78 FR at 45330. However, the Commission notes that the proposed definition of "foreign branch" does not include the requirement that the employees negotiating and agreeing to the terms of the swap (or, if the swap is executed electronically, managing the execution of the swap), other than employees with functions that are solely clerical or ministerial, be located in such foreign branch or in another foreign branch of the U.S. bank. The Commission is of the view that, as discussed above, the second prong of the proposed definition addresses this issue.
[158] Proposed § 23.23(a)(15).
[159] Proposed § 23.23(a)(23).
[160] Proposed § 23.23(a)(10).
[161] Proposed § 23.23(a)(20).

payments and deliveries under the swap pursuant to a master netting or similar trading agreement, and the documentation of the swap specifies that the office for the non-U.S. person is such U.S. branch; or (2) the swap is reflected in the local accounts of the U.S. branch.[162]

Similar to how the terms "foreign branch" and "conducted through a foreign branch" are used under the Proposed Rule to identify swap activity of U.S. entities that is taking place outside the United States and, thus, may be eligible for certain relief from the Commission's requirements under the Proposed Rule, these definitions would be used to identify swap activity that the Commission believes should be considered to take place in the United States and, thus, remain subject to the Commission's requirements addressed in the Proposed Rule, as discussed below with respect to the definitions of "foreign-based swap" and "foreign counterparty." In particular, these proposed definitions are intended to address the concern that an entity would operate outside the United States to evade Dodd-Frank Act requirements and CFTC regulations for a swap while still benefiting from the swap taking place in the United States. The Commission preliminarily believes that the requirements listed in the proposed definitions are appropriate to identify swaps of a non-U.S. banking organization operating through a foreign branch in the United States that should remain subject to Commission requirements addressed in the Proposed Rule.

Consistent with the Commission's proposed approach to foreign branches, a U.S. branch of a non-U.S. banking organization would not include a U.S. affiliate of the

[162] Proposed § 23.23(a)(17).

organization that is incorporated or organized as a separate legal entity. Also consistent with this approach, the Commission declines in the Proposed Rule to recognize U.S. branches of non-U.S. banking organization separately from their non-U.S. principal for purposes of registration.

G. Foreign-Based Swap and Foreign Counterparty

Under the Proposed Rule, the term "foreign-based swap" would mean: (1) a swap by a non-U.S. swap entity, except for a swap conducted through a U.S. branch; or (2) a swap conducted through a foreign branch.[163] The term "foreign counterparty" would mean: (1) a non-U.S. person, except with respect to a swap conducted through a U.S. branch of that non-U.S. person; or (2) a foreign branch where it enters into a swap in a manner that satisfies the definition of a swap conducted through a foreign branch.[164] Together with the proposed defined terms "foreign branch," "swap conducted through a foreign branch," "U.S. branch," and "swap conducted through a U.S. branch" discussed above, these terms would be used to determine which swaps the Commission considers to be foreign swaps of non-U.S. swap entities and foreign branches of U.S. swap entities for which certain relief from Commission requirements would be available under the Proposed Rule, and which swaps should be treated as domestic swaps not eligible for such relief. The Commission is proposing to limit the types of swaps that are eligible for relief, consistent with section 2(i) of the CEA, to address its concern that swaps that demonstrate sufficient indicia of being domestic remain subject to the Commission's requirements addressed by the Proposed Rule, notwithstanding that the swap is entered

[163] Proposed § 23.23(a)(4).
[164] Proposed § 23.23(a)(3).

into by a non-U.S. swap entity or a foreign branch of a U.S. swap entity. Otherwise, the Commission is concerned that an entity or branch might simply be established outside of the United Stated to evade Dodd-Frank Act requirements and CFTC regulations.

As the Commission has previously stated, it has a strong supervisory interest in regulating swap activities that occur in the United States.[165] In addition, consistent with section 2(i) of the CEA, the Commission believes that foreign swaps of non-U.S. swap entities and foreign branches of U.S. swap entities should be eligible for relief from certain of the Commission's requirements. Accordingly, certain portions of the Commission's proposed substituted compliance regime, as well as its proposed exceptions from certain requirements in CFTC regulations (each discussed below in section VI), are designed to be limited to certain foreign swaps of non-U.S. swap entities and foreign branches of U.S. swap entities that the Commission believes should be treated as occurring outside the United States. Specifically, these provisions are applicable only to a swap by a non-U.S. swap entity, except for a swap conducted through a U.S. branch, and a swap conducted through a foreign branch such that it would satisfy the definition of a "foreign-based swap" above. They are not applicable to swaps of non-U.S. swap entities that are conducted through a U.S. branch of that swap entity, and swaps of foreign branches of U.S. swap entities where the foreign branch does not enter into the swaps in a manner that satisfies the definition of a swap conducted through a foreign branch, because, in the Commission's view, the entrance into a swap by a U.S. swap entity (through its foreign branch) or a U.S. branch of a non-U.S. swap entity under

[165] *See* Guidance, 78 FR at 45350, n.513.

these circumstances, demonstrates sufficient indicia of being a domestic swap to be treated as such for purposes of the Proposed Rule.[166] Similarly, in certain cases, the availability of a proposed exception or substituted compliance for a swap would depend on whether the counterparty to such a swap qualifies as a "foreign counterparty" under the Proposed Rule. The Commission is proposing this requirement to ensure that foreign-based swaps of swap entities in which their counterparties demonstrate sufficient indicia of being domestic and, thus, trigger the Commission's supervisory interest in domestic swaps, continue to be subject to the Commission requirements addressed in the Proposed Rule.

The Commission also notes that its approach in the Proposed Rule for U.S. branches of non-U.S. swap entities is parallel to the Commission's approach in the Proposed Rule to provide certain exceptions from Commission requirements or substituted compliance for transactions of foreign branches of U.S. swap entities to take into account the supervisory interest of local regulators, as discussed below in section VI.

H. Request for Comment

The Commission invites comment on all aspects of the Proposed Rule, including each of the definitions discussed above, and specifically requests comments on the following questions. Please explain your responses and provide alternatives to the relevant portions of the Proposed Rule, where applicable.

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[166] The Commission notes that the Guidance took a similar approach with respect to U.S. branches of non-U.S. SDs or MSPs, stating that they would be subject to the transaction-level requirements (discussed in section VI.A below), without substituted compliance. *Id*.

(1) The “U.S. person” definition the Commission is proposing here aligns with the definition of that term adopted by the SEC in the context of its cross-border swap regulations. Should the Commission instead adopt the U.S. person definition used in its Cross-Border Margin Rule? Alternatively, should the Commission instead harmonize the “U.S. person” definition in the Proposed Rule to the interpretation of U.S. person included in the Guidance?

(2) Is it appropriate, as proposed, that commodity pools, pooled accounts, investment funds, or other CIVs that are majority-owned by U.S. persons not be included in the proposed definition of “U.S. person”? Would a majority of such funds or CIVs be subject to margin requirements of foreign jurisdictions? Is it accurate to assume that the exposure of investors to losses in CIVs is generally capped at their investment amount? Does tracking a CIV’s beneficial ownership pose challenges in certain circumstances?

(3) When determining the principal place of business for a CIV, should the Commission consider including as a factor whether the senior personnel responsible for the formation and promotion of the CIV are located in the United States, similar to the approach in the Cross-Border Margin Rule?[167]

(4) Should the Commission include an unlimited U.S. responsibility prong in the definition of “U.S. person”? If not, should the Commission revise its interpretation of “guarantee” in a manner consistent with the SEC to ensure that persons that would otherwise be considered U.S. persons pursuant to the unlimited U.S. responsibility prong

[167] *See* Cross-Border Margin Rule, 81 FR at 34823.

would nonetheless be considered entities with guarantees from a U.S. person? Are there any persons that would be captured under the unlimited U.S. responsibility prong?

(5) Should the "U.S. person" definition include a catch-all provision? What types of entities would be expected to fall under such a provision?

(6) Should the Commission consider providing an exemption from the "U.S. person" definition for pension plans organized in the U.S. that are primarily for the benefit of the foreign employees of U.S.-based entities, consistent with the Cross-Border Margin Rule's "U.S. person" definition?[168]

(7) Should the catch-all provision for international financial institutions be restricted to organizations in which the U.S. government is a shareholder?

(8) Does the proposed SRS definition appropriately capture persons that raise greater supervisory concerns relative to Other Non-U.S. Persons whose swap obligations are not guaranteed by a U.S. person? If not, how should the definition be revised? Is $50 billion an appropriate threshold to determine when an ultimate U.S. parent entity may have a significant impact on the U.S. financial system?

(9) Should the Commission consider alternative or additional tests for whether a person would be a significant subsidiary or an SRS? Would an alternate approach to the use of a three year rolling average throughout the proposed significance tests more effectively mitigate the risk of an entity frequently varying between being a significant subsidiary and not being a significant subsidiary?

[168] *See* 17 CFR 23.260(a)(10)(iv).

(10) Should the exclusion set out in proposed § 23.23(a)(12)(i) include any entity that is subject to consolidated supervision and regulation by the Federal Reserve Board rather than being limited to subsidiaries of BHCs (for example, intermediate holding companies of foreign banking organizations that are subject to supervision by the Federal Reserve Board)?

(11) Does the proposed definition of ultimate U.S. parent entity adequately account for affiliated entity structures with multiple U.S. parent entities? Are there situations where the proposed ultimate U.S. parent entity definition would result in more than one ultimate U.S. person entity being identified?

(12) Are the proposed tests for compliance with Basel III capital standards and compliance with margin requirements in a comparable jurisdiction appropriate? What are alternative ways for a person to confirm it is compliant with Basel III capital standards?

(13) In the interests of harmonizing with the SEC, should the Commission use the concept of "conduit affiliate," as in 17 CFR 240.3a71-3(a)(1), instead of the concept of SRS?[169] Or should the Commission address both conduit affiliates and SRSs in its cross-border rules?

(14) Should the definition of "foreign branch" include the requirement that the branch be "subject to substantive regulation in banking or financing in the jurisdiction

[169] The Commission notes that the Guidance included the concept of a "conduit affiliate." Although the Commission did not define the concept of a "conduit affiliate" it did identify certain factors it believed were relevant to the determination of whether an entity would be considered a conduit affiliate of a U.S. person. *See* Guidance, 78 FR at 45359. The Commission, in this Proposed Rule, is not separately including the concept of a "conduit affiliate" because the concerns posed by a conduit affiliate are intended to be addressed through the proposed definition and treatment of SRSs.

where it is located," given that the definition of "foreign branch" under Regulation K does not contain such a requirement? Similarly, should the definition of "U.S. branch" include the requirement that the branch be "subject to substantive banking regulation in the state or district where located"?

(15) Should the definitions of "foreign branch" and "swap conducted through a foreign branch" be further harmonized with the definition of "foreign branch" by the SEC in rule 3a71-3(a)(2) under the Exchange Act and the definition of "transaction conducted through a foreign branch" by the SEC in rule 3a71-3(a)(3) under the Securities Exchange Act?[170] Should the Commission instead use the definitions of those terms in the Guidance?[171] The Commission proposes that a swap will be deemed to be entered into by such foreign branch in the normal course of business if swaps of the type in question are primarily, but not exclusively, entered into by personnel located in the branch (or another foreign branch of the U.S. bank). Should the Commission instead stipulate that a swap will be considered to be "entered into by such foreign branch in the normal course of business" only if personnel located in the U.S. do not participate in the negotiation or

[170] The SEC defined the term "foreign branch" in Exchange Act rule 3a71–3(a)(2), 17 CFR 240.3a71–3(a)(2), to mean any branch of a U.S. bank if: (1) the branch is located outside the United States; (2) the branch operates for valid business reasons; and (3) the branch is engaged in the business of banking and is subject to substantive banking regulation in the jurisdiction where located. The SEC defined the term "transaction conducted through a foreign branch" in Exchange Act rule 3a71–3(a)(3), 17 CFR 240.3a71–3(a)(3), to mean a security-based swap transaction that is arranged, negotiated, and executed by a U.S. person through a foreign branch of such U.S. person if: (1) the foreign branch is the counterparty to such security-based swap transaction; and (2) the security-based swap transaction is arranged, negotiated, and executed on behalf of the foreign branch solely by persons located outside the United States. *See also* SEC Cross-Border Rule, 79 FR 47278.

[171] *See* Guidance, 78 FR at 45328-31 (discussing that scope of the term "foreign branch" and the Commission's consideration of whether a swap with a foreign branch of a U.S. bank by a non-U.S. person should count toward the non-U.S. person's de minimis threshold calculation).

execution of such swap? Should the Commission instead take an alternative approach? If so, what should it be?

(16) Should the definitions of "foreign branch" and "U.S. branch" be restricted to entities engaged in the business of banking and/or finance and subject to substantive regulation in banking and/or finance? If not, what other types of entities should be considered branches?

(17) Are the definitions of "U.S. branch" and "swap conducted through a U.S. branch" effective to appropriately capture transactions that should be considered to be domestic rather than foreign, such that they are ineligible for certain exceptions from the group B and group C requirements and substituted compliance for the group B requirements (discussed in section VI below)? If not, what changes should be made to the definitions?

(18) Are the definitions of "foreign-based swap," "foreign branch," "foreign counterparty," and "swap conducted through a foreign branch" effective to appropriately capture transactions that should be considered to be foreign rather than domestic, such that they are eligible for certain exceptions from the group B and group C requirements and substituted compliance for the group B requirements (discussed in section VI below)? If not, what changes should be made to the definitions?

III. Cross-Border Application of the Swap Dealer Registration Threshold

CEA section 1a(49) defines the term "swap dealer" to include any person that: (1) holds itself out as a dealer in swaps; (2) makes a market in swaps; (3) regularly enters into swaps with counterparties as an ordinary course of business for its own account; or

(4) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps (collectively referred to as "swap dealing," "swap dealing activity," or "dealing activity").[172] The statute also requires the Commission to promulgate regulations to establish factors with respect to the making of a determination to exempt from designation as an SD an entity engaged in a de minimis quantity of swap dealing.[173]

In accordance with CEA section 1a(49), the Commission issued the Entities Rule,[174] which, among other things, further defined the term "swap dealer" and excluded from designation as an SD any entity that engages in a de minimis quantity of swap dealing with or on behalf of its customers.[175] Specifically, the definition of "swap dealer" in § 1.3 provides that a person shall not be deemed to be an SD as a result of its swap dealing activity involving counterparties unless, during the preceding 12 months, the aggregate gross notional amount of the swap positions connected with those dealing activities exceeds the de minimis threshold.[176] Paragraph (4) of that definition further requires that, in determining whether its swap dealing activity exceeds the de minimis threshold, a person must include the aggregate gross notional value of the swaps connected with the dealing activities of its affiliates under common control.[177] For purposes of the Proposed Rule, the Commission construes "affiliates under common

[172] 7 U.S.C. 1a(49)(A). In general, a person that satisfies any one of these prongs is deemed to be engaged in swap dealing activity.
[173] 7 U.S.C. 1a(49)(D).
[174] Entities Rule, 77 FR 30596.
[175] *See* 17 CFR 1.3, Swap dealer, paragraph (4); Entities Rule, 77 FR 30596.
[176] *See* 17 CFR 1.3, Swap dealer, paragraph (4)(i)(A). The de minimis threshold is set at $8 billion, except with regard to swaps with special entities for which the threshold is $25 million. *See* De Minimis Exception to the Swap Dealer Definition, 83 FR 56666 (Nov. 13, 2018).
[177] *See* 17 CFR 1.3, Swap dealer, paragraph (4)(i)(A).

control" by reference to the Entities Rule, which defined control as the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract or otherwise.[178] Accordingly, any reference in the Proposed Rule to "affiliates under common control" with a person would include affiliates that are controlling, controlled by, or under common control with such person.

The Commission is now proposing rules to address how the de minimis threshold should apply to the cross-border swap dealing transactions of U.S. and non-U.S. persons. Specifically, the Proposed Rule identifies when a potential SD's cross-border dealing activities should be included in its de minimis threshold calculation and when they may properly be excluded. As discussed below, whether a potential SD would include a particular swap in its de minimis threshold calculation would depend on how the entity is classified (*e.g.*, U.S. person, SRS, etc.) and, in some cases, the jurisdiction in which a non-U.S. person is regulated.

A. U.S. Persons

Under the Proposed Rule, consistent with the Guidance,[179] a U.S. person would include all of its swap dealing transactions in its de minimis threshold calculation without exception.[180] As discussed in section II.A above, the term "U.S. person" would encompass a person that, by virtue of being domiciled, organized, or having its principal place of business in the United States, raises the concerns intended to be addressed by the

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[178] *See* Entities Rule, 77 FR at 30631 n.437.
[179] *See* Guidance, 78 FR at 45326.
[180] Proposed § 23.23(b)(1).

Dodd-Frank Act, regardless of the U.S. person status of its counterparty. In addition, a person's status as a U.S. person would be determined at the entity level and, thus, a U.S. person would include the swap dealing activity of operations that are part of the same legal person, including those of its foreign branches. Therefore, a U.S. person would include in its SD de minimis threshold calculation dealing swaps entered into by a foreign branch of the U.S. person.[181]

B. Non-U.S. Persons

Under the Proposed Rule, whether a non-U.S. person would need to include a swap in its de minimis threshold calculation would depend on the non-U.S. person's status, the status of its counterparty, and, in some cases, the jurisdiction in which the non-U.S. person is regulated. Specifically, the Proposed Rule would require a person that is a Guaranteed Entity or an SRS to count all of its dealing swaps towards the de minimis threshold.[182] In addition, an Other Non-U.S. Person would be required to count dealing swaps with a U.S. person toward its de minimis threshold calculation, except for swaps conducted through a foreign branch of a registered SD.[183] Further, subject to certain

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[181] The Commission notes that this approach mirrors the SEC's approach in its cross-border rule. *See* 17 CFR 240.3a71-3(b)(1)(i); SEC Cross-Border Rule, 79 FR at 47302, 47371.

[182] As discussed in section II.B above, for purposes of this release and ease of reading, a non-U.S. person whose obligations under the swaps are subject to a guarantee by a U.S. person is being referred to as a "Guaranteed Entity." A non-U.S. person may be a Guaranteed Entity with respect to swaps with certain counterparties, but not be deemed a Guaranteed Entity with respect to swaps with other counterparties. Also, a non-U.S. person could be a Guaranteed Entity or an Other Non-U.S. Person, depending on the specific swap.

[183] This release uses the phrase "through a foreign branch" to describe swaps that are entered into by a foreign branch and which meet the definition of "swap conducted through a foreign branch." As stated, the Commission is proposing that "swap conducted through a foreign branch" would mean a swap entered into by a foreign branch where: (1) The foreign branch or another foreign branch is the office through which the U.S. person makes and receives payments and deliveries under the swap pursuant to a master netting or similar trading agreement, and the documentation of the swap specifies that the office for the U.S. person is

exceptions, the Proposed Rule would require an Other Non-U.S. Person to count dealing swaps toward its de minimis threshold calculation if the counterparty to such swaps is a Guaranteed Entity.

1. Swaps by a Significant Risk Subsidiary

Under the Proposed Rule, an SRS would include all of its dealing swaps in its de minimis threshold calculation without exception.[184] As discussed in section II.C above, the proposed definition of SRS encompasses a person that, by virtue of being a significant subsidiary of a U.S. person, and not being subject to prudential supervision as a subsidiary of a BHC or subject to comparable capital and margin rules, raises the concerns intended to be addressed by the Dodd-Frank Act requirements addressed by the Proposed Rule, regardless of the U.S. person status of its counterparty.

The Commission believes that treating an SRS differently from a U.S. person could create a substantial regulatory loophole, incentivizing U.S. persons to conduct their dealing business with non-U.S. persons through significant non-U.S. subsidiaries to avoid application of the Dodd-Frank Act SD requirements. Allowing swaps entered into by SRSs, which have the potential to impact the ultimate U.S. parent entity and U.S. commerce, to be treated differently depending on how the parties structure their transactions could undermine the effectiveness of the Dodd-Frank Act swaps provisions and related Commission regulations addressed by the Proposed Rule. Applying the same

such foreign branch; (2) the swap is entered into by such foreign branch in its normal course of business; and (3) the swap is reflected in the local accounts of the foreign branch.

[184] Proposed § 23.23(b)(1).

standard to similar transactions helps to limit those incentives and regulatory implications.

However, under the Proposed Rule, an Other Non-U.S. Person would not be required to count a dealing swap with an SRS toward its de minimis threshold calculation, unless the SRS was also a Guaranteed Entity (and no exception applied). As noted above, an SRS would be required to count all of its dealing swaps. However, where an Other Non-U.S. Person is entering into a dealing swap with an SRS, requiring the Other Non-U.S. Person to count the swap towards the de minimis threshold could cause the Other Non-U.S. Person to stop engaging in swap activities with the SRS. The Commission believes it is important to ensure that an SRS, particularly a commercial entity, continues to have access to swap liquidity from Other Non-U.S. Persons for hedging or other non-dealing purposes.

In addition, a person's status as an SRS would be determined at the entity level and, thus, an SRS would include the swap dealing activity of operations that are part of the same legal person, including those of its branches. Therefore, an SRS would include in its SD de minimis threshold calculation dealing swaps entered into by a branch of the SRS.

2. Swaps with a U.S. Person

The Proposed Rule would require a non-U.S. person to count all dealing swaps with a counterparty that is a U.S. person toward its de minimis threshold calculation, except for swaps with a counterparty that is a foreign branch of a registered U.S. SD and such swap meets the definition of being "conducted through a foreign branch" of such registered SD.[185] Generally, the Commission believes that all potential SDs should include in their de minimis threshold calculations any swap with a U.S. person. As discussed in section II.A, the proposed term "U.S. person" encompasses persons that inherently raise the concerns intended to be addressed by the Dodd-Frank Act regardless of the U.S. person status of their counterparty. In the event of a default or insolvency of a non-U.S. SD, the SD's U.S. counterparties could be adversely affected. A credit event, including funding and liquidity problems, downgrades, default, or insolvency at a non-U.S. SD could therefore have a direct adverse impact on its U.S. counterparties, which could in turn create the risk of disruptions to the U.S. financial system.

The Proposed Rule's approach in allowing a non-U.S. person to exclude swaps conducted through a foreign branch of a registered SD from its de minimis threshold calculation is consistent with the Guidance.[186] The Commission's view is that its regulatory interest in these swaps is not sufficient to warrant creating a potential competitive disadvantage for foreign branches of U.S. SDs with respect to their foreign entity competitors by requiring non-U.S. persons to count trades with them toward their de minimis threshold calculations. In this regard, the Commission notes that a swap conducted through a foreign branch of a registered SD would trigger certain Dodd-Frank Act transactional requirements, particularly margin requirements, and, thus, such swap activity would not be conducted outside the Dodd-Frank Act regime. Moreover, in addition to certain Dodd-Frank Act requirements that would apply to such swaps, other foreign regulatory requirements may also apply similar transactional requirements to the

[185] Proposed § 23.23(b)(2)(i).
[186] *See* Guidance, 78 FR at 45323-24.

transactions.[187] Accordingly, the Commission believes that it would be appropriate and consistent with section 2(i) of the CEA to allow non-U.S. persons to exclude from their de minimis calculation any swap dealing transactions conducted through a foreign branch of a registered SD. However, this exception would not apply for Guaranteed Entities (discussed below) or SRSs (discussed above), who would have to count all of their dealing swaps.

3. Swaps Subject to a Guarantee

In an approach that is generally consistent with the Guidance,[188] the Proposed Rule would require a non-U.S. person to include in its de minimis threshold calculation swap dealing transactions where its obligations under the swaps are subject to a guarantee by a U.S. person.[189] The Commission believes that this result is appropriate because the swap obligations of a Guaranteed Entity are identical, in relevant aspects, to a swap entered into directly by a U.S. person. As a result of the guarantee, the U.S. guarantor bears risk arising out of the swap as if it had entered into the swap directly. The U.S. guarantor's financial resources in turn enable the Guaranteed Entity to engage in dealing activity, because the Guaranteed Entity's counterparties will look to both the Guaranteed Entity and its U.S. guarantor to ensure performance of the swap. Absent the guarantee

[187] As noted above in section I.B, significant and substantial progress has been made in the world's primary swaps trading jurisdictions to implement the G20 swaps reform commitments.

[188] The Guidance stated that where a non-U.S. affiliate of a U.S. person has its swap dealing obligations with non-U.S. persons guaranteed by a U.S. person, the guaranteed affiliate generally would be required to count those swap dealing transactions with non-U.S. persons (in addition to its swap dealing transactions with U.S. persons) for purposes of determining whether the affiliate exceeds a de minimis amount of swap dealing activity and must register as an SD. Guidance, 78 FR at 45312-13. As discussed above, the Proposed Rule would not require that the guarantor be an affiliate of the guaranteed person for that person to be a Guaranteed Entity.

[189] Proposed § 23.23(b)(2)(ii).

from the U.S. person, a counterparty may choose not to enter into the swap or may not do so on the same terms. In this way, the Guaranteed Entity and the U.S. guarantor effectively act together to engage in the dealing activity.[190]

Further, the Commission believes that treating a Guaranteed Entity differently from a U.S. person could create a substantial regulatory loophole, incentivizing U.S. persons to conduct their dealing business with non-U.S. persons through non-U.S. affiliates, with a U.S. guarantee, to avoid application of the Dodd-Frank Act SD requirements. Allowing transactions that have a similar economic reality with respect to U.S. commerce to be treated differently depending on how the parties structure their transactions could undermine the effectiveness of the Dodd-Frank Act swap provisions and related Commission regulations addressed by the Proposed Rule. Applying the same standard to similar transactions helps to limit those incentives and regulatory implications.

The Commission is also proposing that a non-U.S. person must count dealing swaps with a Guaranteed Entity in its SD de minimis threshold calculation, except when: (1) the Guaranteed Entity is registered as an SD; or (2) the Guaranteed Entity's swaps are subject to a guarantee by a U.S. person that is a non-financial entity.[191] The guarantee of a swap is an integral part of the swap and, as discussed above, counterparties may not be willing to enter into a swap with a Guaranteed Entity in the absence of the guarantee. The Commission recognizes that, given the highly integrated corporate structures of

[190] The Commission notes that this view is consistent with the SEC's approach in its cross-border rule. *See* SEC Cross-Border Rule, 79 FR at 47289.
[191] Proposed § 23.23(b)(2)(iii).

global financial enterprises described above, financial groups may elect to conduct their swap dealing activity in a number of different ways, including through a U.S. person or through a non-U.S. affiliate that benefits from a guarantee from a U.S. person. Therefore, in order to avoid creating a regulatory loophole, the Commission believes that swaps of a non-U.S. person with a Guaranteed Entity should receive the same treatment as swaps with a U.S. person. The two exceptions discussed above are intended to address those situations where the risk of the swap between the non-U.S. person and the Guaranteed Entity would be otherwise managed under the Dodd-Frank Act swap regime or is primarily outside the U.S. financial sector.[192]

Where a non-U.S. person (that itself is not a Guaranteed Entity or an SRS) enters into swap dealing transactions with a Guaranteed Entity that is a registered SD, the Commission preliminarily believes it is appropriate to permit the non-U.S. person not to count its dealing transactions with the Guaranteed Entity against the non-U.S. person's de minimis threshold for two principal reasons. First, requiring the non-U.S. person to count such swaps may incentivize them to not engage in dealing activity with Guaranteed Entities, thereby contributing to market fragmentation and competitive disadvantages for entities wishing to access foreign markets. Second, one counterparty to the swap is a registered SD, and therefore is subject to comprehensive swap regulation under the oversight of the Commission.

[192] In this regard, the Commission notes that the SEC's cross-border rules do not require a non-U.S. person that is not a conduit affiliate or guaranteed by a U.S. person to count dealing swaps with a guaranteed entity toward its de minimis threshold in any case. Below we solicit comment on whether the CFTC should adopt a similar approach. *See* SEC Cross-Border Rule, 79 FR at 47322.

In addition, a non-U.S. person that is not a Guaranteed Entity or an SRS would not include in its de minimis threshold calculation its swap dealing transactions with a Guaranteed Entity where the Guaranteed Entity is guaranteed by a non-financial entity. In these circumstances, systemic risk to U.S. financial markets is mitigated because the U.S. guarantor is a non-financial entity whose primary business activities are not related to financial products and such activities primarily occur outside the U.S. financial sector.[193] For purposes of the Proposed Rule, the Commission interprets "non-financial entity" to mean a counterparty that is not an SD, an MSP, or a financial end-user (as defined in the SD and MSP margin rule in § 23.151).

C. Aggregation Requirement

Paragraph (4) of the SD definition in § 1.3 requires that, in determining whether its swap dealing transactions exceed the de minimis threshold, a person must include the aggregate notional value of any swap dealing transactions entered into by its affiliates under common control.[194] Consistent with CEA section 2(i), the Commission interprets this aggregation requirement in a manner that applies the same aggregation principles to all affiliates in a corporate group, whether they are U.S. or non-U.S. persons. Accordingly, under the Proposed Rule and consistent with the Guidance,[195] a potential SD, whether a U.S. or non-U.S. person, would aggregate all swaps connected with its dealing activity with those of persons controlling, controlled by, or under common

[193] Moreover, the SRS definition would include those non-financial U.S. parent entities that meet the risk-based thresholds set out above in section II.C.
[194] 17 CFR 1.3, Swap dealer, paragraph (4).
[195] *See* Guidance, 78 FR at 45323.

control with[196] the potential SD to the extent that these affiliated persons are themselves required to include those swaps in their own de minimis threshold calculations, unless the affiliated person is itself a registered SD. The Commission notes that its proposed approach would ensure that the aggregate notional value of applicable swap dealing transactions of all such unregistered U.S. and non-U.S. affiliates does not exceed the de minimis level.

Stated in general terms, the Commission's approach allows both U.S. persons and non-U.S. persons in an affiliated group to engage in swap dealing activity up to the de minimis threshold. When the affiliated group meets the de minimis threshold in the aggregate, one or more affiliate(s) (a U.S. affiliate or a non-U.S. affiliate) would have to register as an SD so that the relevant swap dealing activity of the unregistered affiliates remains below the threshold. The Commission recognizes the borderless nature of swap dealing activities, in which a dealer may conduct swap dealing business through its various affiliates in different jurisdictions, and believes that its approach would address the concern that an affiliated group of U.S. and non-U.S. persons engaged in swap dealing transactions with a significant connection to the United States may not be required to register solely because such swap dealing activities are divided among affiliates that all individually fall below the de minimis threshold.

D. Certain Exchange-Traded and Cleared Swaps

The Proposed Rule, in an approach that is generally consistent with the Guidance, would allow a non-U.S. person that is not a Guaranteed Entity or SRS to exclude from its

[196] The Commission clarifies that for this purpose, the term "affiliates under common control" would include parent companies and subsidiaries.

de minimis threshold calculation any swap that it anonymously enters into on a designated contract market ("DCM"), a swap execution facility ("SEF") that is registered with the Commission or exempted by the Commission from SEF registration pursuant to section 5h(g) of the CEA, or a foreign board of trade ("FBOT") that is registered with the Commission pursuant to part 48 of its regulations,[197] if such swap is also cleared through a registered or exempt derivatives clearing organization ("DCO").[198]

When a non-U.S. person enters into a swap that is executed anonymously on a registered or exempt SEF, DCM, or registered FBOT, the Commission recognizes that the non-U.S. person would not have the necessary information about its counterparty to determine whether the swap should be included in its de minimis threshold calculation. The Commission therefore believes that in this case the practical difficulties make it reasonable for the swap to be excluded altogether.[199]

The Proposed Rule is consistent with the Guidance but would expand the exception to include SEFs and DCOs that are exempt from registration under the CEA, and also states that SRSs do not qualify for this exception. The CEA provides that the Commission may grant an exemption from registration if it finds that a foreign SEF or DCO is subject to comparable, comprehensive supervision and regulation by the

[197] The Commission would consider the proposed exception described herein also to apply with respect to an FBOT that provides direct access to its order entry and trade matching system from within the U.S. pursuant to no-action relief issued by Commission staff.

[198] Proposed § 23.23(d).

[199] Additionally, as the Commission has clarified in the past, when a non-U.S. person clears a swap through a registered or exempt DCO, such non-U.S. person would not have to include the resulting swap (*i.e.*, the novated swap) in its de minimis threshold calculation. *See, e.g.*, 2016 Proposal, 81 FR at 71957 n.88. A swap that is submitted for clearing is extinguished upon novation and replaced by new swap(s) that result from novation. *See* 17 CFR 39.12(b)(6). *See also* Derivatives Clearing Organization General Provisions and Core Principles, 76 FR 69334, 69361 (Nov. 8, 2011). Where a swap is created by virtue of novation, such swap does not implicate swap dealing, and therefore it would not be appropriate to include such swaps in determining whether a non-U.S. person should register as an SD.

appropriate governmental authorities in the SEF's or DCO's home country.[200] The Commission believes that the policy rationale for providing relief to swaps anonymously executed on a SEF, DCM, or FBOT and then cleared also extends to swaps executed on a foreign SEF and/or cleared through a foreign DCO that has been granted an exemption from registration. As noted, the foreign SEF or DCO would be subject to comparable and comprehensive regulation, as is the case with U.S.-based SEFs and DCMs.[201]

E. Request for Comment

The Commission invites comment on all aspects of the cross-border application of the SD registration threshold described in sections III.A through III.D, and specifically requests comments on the following questions. Please explain your responses and provide alternatives to the relevant portions of the Proposed Rule, where applicable.

(19) Should a non-U.S. person be permitted to exclude from its de minimis threshold calculation swap dealing transactions conducted through a foreign branch of a registered SD?

(20) As discussed in section II.F, under the Proposed Rule, the term "U.S. branch" would mean a branch or agency of a non-U.S. banking organization where such branch or agency: (1) is located in the United States; (2) maintains accounts independently of the home office and other U.S. branches, with the profit or loss accrued

[200] *See* CEA sections 5h for the SEF exemption provision and 5b(h) for the DCO exemption provision.

[201] The Commission recognizes that it recently issued two proposed rulemakings regarding non-U.S. DCOs. One applied to DCOs registered with the Commission. Registration With Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, 84 FR 34819 (proposed July 19, 2019). That proposal, and a second that applied to exempt DCOs, Exemption From Derivatives Clearing Organization Registration, 84 FR 35456 (proposed July 23, 2019), both applied to non-U.S. DCOs that do not pose substantial risk to the U.S. financial system based on metrics set forth therein. The Commission may modify this exception for exchange-traded and cleared swaps as necessary, based on any DCO-related proposed rules that are adopted by the Commission.

at each branch determined as a separate item for each U.S. branch; and (3) engages in the business of banking and is subject to substantive banking regulation in the state or district where located. Given that definition, would it be appropriate to require a U.S. branch to include in its SD de minimis threshold calculation all of its swap dealing transactions, as if they were swaps entered into by a U.S. person? Would it be appropriate to require an Other Non-U.S. Person to include in its SD de minimis threshold calculation dealing swaps conducted through a U.S. branch?

(21) Under the Proposed Rule, an Other Non-U.S. Person would not be required to include its dealing swaps with an SRS or an Other Non-U.S. Person in its SD de minimis threshold. The Commission invites comment as to whether, and in what circumstances, a non-U.S. person should be required to include dealing swaps with a non-U.S. person in its SD de minimis threshold calculation if any of the risk of such swaps is transferred to an affiliated U.S. SD through one or more inter-affiliate swaps, and as to whether it would be too complex or costly to monitor and implement such a rule.[202]

(22) With respect to proposed § 23.23(b)(2)(iii), should the Commission follow the SEC's approach, which does not require a non-U.S. person that is not a conduit affiliate nor guaranteed by a U.S. person to count dealing swaps with a non-U.S. person whose security-based swap transactions are guaranteed by a U.S. person. The SEC noted that "concerns regarding the risk posed to the United States by such security-based

[202] The Commission notes that the Commission's final margin rule requires covered swap entities to collect initial margin from certain affiliates that are not subject to comparable initial margin collection requirements on their own outward-facing swaps with financial end-users, which addresses some of the credit risks associated with the outward-facing swaps. *See* 17 CFR 23.159; Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636, 673-74 (Jan. 6, 2016).

swaps, and regarding the potential use of such guaranteed affiliates to evade the Dodd-Frank Act . . . are addressed by the requirement that guaranteed affiliates count their own dealing activity against the de minimis thresholds when the counterparty has recourse to a U.S. person."[203]

IV. Cross-Border Application of the Major Swap Participant Registration Tests

CEA section 1a(33) defines the term "major swap participant" to include persons that are not SDs but that nevertheless pose a high degree of risk to the U.S. financial system by virtue of the "substantial" nature of their swap positions.[204] In accordance with the Dodd-Frank Act and CEA section 1a(33)(B), the Commission adopted rules further defining "major swap participant" and providing that a person would not be deemed an MSP unless its swap positions exceed one of several thresholds.[205] The thresholds were designed to take into account default-related credit risk, the risk of multiple market participants failing close in time, and the risk posed by a market participant's swap positions on an aggregate level.[206] The Commission also adopted

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[203] SEC Cross-Border Rule, 79 FR at 47322.

[204] *See* 7 U.S.C. 1a(33)(A) (defining "major swap participant" to mean any person that is not an SD and either (1) maintains a substantial position in swaps for any of the major swap categories, subject to certain exclusions; (2) whose outstanding swaps create substantial counterparty exposure that could have serious effects on the U.S. financial system; or (3) is a highly leveraged financial entity that is not subject to prudential capital requirements and that maintains a substantial position in swaps for any of the major swap categories. *See also* 17 CFR 1.3, Major swap participant, paragraph (1); 156 Cong. Rec. S5907 (daily ed. July 15, 2010) (colloquy between Senators Hagen and Lincoln, discussing how the goal of the major participant definitions was to "focus on risk factors that contributed to the recent financial crisis, such as excessive leverage, under-collateralization of swap positions, and a lack of information about the aggregate size of positions").

[205] *See* 17 CFR 1.3, Major swap participant, Substantial counterparty exposure, Substantial position, Financial entity; highly leveraged, Hedging or mitigating commercial risk, and Category of swaps; major swap category. *See also* Entities Rule, 77 FR 30596.

[206] *See* Entities Rule, 77 FR at 30666 (discussing the guiding principles behind the Commission's definition of "substantial position" in 17 CFR 1.3); *id.* at 30683 (noting that the Commission's definition of "substantial counterparty exposure" in 17 CFR 1.3 is founded on similar principles as its definition of "substantial position").

interpretive guidance stating that, for purposes of the MSP analysis, an entity's swap positions would be attributable to a parent, other affiliate, or guarantor to the extent that the counterparty has recourse to the parent, other affiliate, or guarantor and the parent or guarantor is not subject to capital regulation by the Commission, SEC, or a prudential regulator ("attribution requirement").[207]

The Commission is now proposing rules to address the cross-border application of the MSP thresholds to the swap positions of U.S. and non-U.S. persons.[208] Applying CEA section 2(i) and principles of international comity, the Proposed Rule identifies when a potential MSP's cross-border swap positions would apply toward the MSP thresholds and when they may be properly excluded. As discussed below, whether a potential registrant would include a particular swap in its MSP calculation would depend on whether the potential registrant is a U.S. person, a Guaranteed Entity, an SRS, or an Other Non-U.S. Person.[209] The Proposed Rule's approach for the cross-border application of the MSP thresholds is similar to the approach described above for the SD threshold.

A. U.S. Persons

Under the Proposed Rule, all of a U.S. person's swap positions would apply toward the MSP registration thresholds without exception.[210] As discussed in the context of the Proposed Rule's approach to applying the SD de minimis registration threshold, by

[207] *Id.* at 30689.
[208] Proposed § 23.23(c).
[209] As indicated above, for purposes of the Proposed Rule, an "Other Non-U.S. Person" refers to a non-U.S. person that is neither a Guaranteed Entity nor an SRS.
[210] Proposed § 23.23(c)(1).

virtue of it being domiciled or organized in the United States, or the inherent nature of its connection to the United States, all of a U.S. person's activities have a significant nexus to U.S. markets, giving the Commission a particularly strong regulatory interest in its swap activities.[211] Accordingly, the Commission believes that all of a U.S. person's swap positions, regardless of where they occur or the U.S. person status of the counterparty, should apply toward the MSP thresholds.

B. Non-U.S. Persons

Under the Proposed Rule, whether a non-U.S. person would include a swap position in its MSP threshold calculation would depend on its status, the status of its counterparty, or the characteristics of the swap. Specifically, the Proposed Rule would require a person that is a Guaranteed Entity or an SRS to count all of its swap positions. In addition, an Other Non-U.S. Person would be required to count all swap positions with a U.S. person, except for swaps conducted through a foreign branch of a registered SD. Subject to certain exceptions, the Proposed Rule would also require an Other Non-U.S. Person to count all swap positions if the counterparty to such swaps is a Guaranteed Entity.[212]

[211] *See supra* section III.A.

[212] As discussed in sections II.B and III.B above, for purposes of this release and ease of reading, such a non-U.S. person whose obligations under the swaps are subject to a guarantee by a U.S. person is being referred to as a "Guaranteed Entity." Depending on the characteristics of the swap, a non-U.S. person may be a Guaranteed Entity with respect to swaps with certain counterparties, but not be deemed a Guaranteed Entity with respect to swaps with other counterparties.

1. Swaps by a Significant Risk Subsidiary

Under the Proposed Rule, an SRS would include all of its swap positions in its MSP threshold calculation.[213] As discussed in section II.C above, the proposed term SRS encompasses a person that, by virtue of being a significant subsidiary of a U.S. person, and not being subject to prudential supervision as a subsidiary of a BHC or subject to comparable capital and margin rules, raises the concerns intended to be addressed by the Dodd-Frank Act requirements addressed by the Proposed Rule, regardless of the U.S. person status of its counterparty.

The Commission believes that treating an SRS differently from a U.S. person could create a substantial regulatory loophole by incentivizing U.S. persons to conduct their swap business with non-U.S. persons through significant non-U.S. subsidiaries to avoid application of the Dodd-Frank Act MSP requirements. Allowing swaps entered into by SRSs, which have the potential to impact the ultimate U.S. parent entity and U.S. commerce, to be treated differently depending on how the parties structure their transactions could undermine the effectiveness of the Dodd-Frank Act swap provisions and related Commission regulations addressed by the Proposed Rule. Applying the same standard to similar swap positions helps to limit those incentives and regulatory implications.

In addition, a person's status as an SRS would be determined at the entity level and, thus, an SRS would include the swap positions that are part of the same legal person,

[213] Proposed § 23.23(c)(1).

including those of its branches. Therefore, an SRS would include in its MSP threshold calculation swap positions entered into by a branch of the SRS.

2. Swap Positions with a U.S. Person

Under the Proposed Rule, a non-U.S. person would include all of its swap positions with U.S. persons, unless the transaction is a swap conducted through a foreign branch of a registered SD.[214] Generally, the Commission believes that a potential MSP should include in its MSP threshold calculation any swap position with a U.S. person. As discussed above, the term "U.S. person" encompasses persons that inherently raise the concerns intended to be addressed by the Dodd-Frank Act, regardless of the U.S. person status of their counterparty. The default or insolvency of the non-U.S. person would have a direct adverse effect on a U.S. person and, by virtue of the U.S. person's significant nexus to the U.S. financial system, potentially could result in adverse effects or disruption to the U.S. financial system as a whole, particularly if the non-U.S. person's swap positions are substantial enough to exceed an MSP registration threshold.

The Proposed Rule's approach in allowing a non-U.S. person to exclude swap positions conducted through a foreign branch of a registered SD is consistent with the approach described in section III.B.2 for cross-border treatment with respect to SDs. A swap conducted through a foreign branch of a registered SD would trigger the Dodd-Frank Act transactional requirements (or comparable requirements) and therefore mitigate concern that this exclusion could be used to engage in swap activities outside the

[214] Proposed § 23.23(c)(2)(i).

Dodd-Frank Act regime.[215] Accordingly, the Commission believes that it would be appropriate and consistent with section 2(i) to allow a non-U.S. person, that is not a Guaranteed Entity or SRS, to exclude from its MSP threshold calculation any swaps conducted through a foreign branch of a registered SD. The Commission recognizes that the Guidance provides that such swaps would need to be cleared or that the documentation of the swaps would have to require the foreign branch to collect daily variation margin, with no threshold, on its swaps with such non-U.S. person.[216] The Proposed Rule does not include such a requirement given that the foreign branch of the registered SD would nevertheless be required to post and collect margin, as required by the SD margin rules. In addition, a non-U.S. person's swaps conducted through a foreign branch of a registered SD must be addressed in the SD's risk management program. Such program must account for, among other things, overall credit exposures to non-U.S. persons.[217]

3. Swap Positions Subject to a Guarantee

The Proposed Rule would require a non-U.S. person to include in its MSP calculation each swap position with respect to which it is a Guaranteed Entity.[218] As

[215] The Commission believes that the Dodd-Frank Act-related requirements that the transaction would be subject to as a result of a registered SD being a counterparty would also mitigate concerns that the non-U.S. person would not be subject to CFTC capital rules (when implemented).

[216] *See* Guidance, 78 FR at 45324-25.

[217] *See* 17 CFR 23.600(c)(4)(ii), requiring registered SDs and MSPs to have credit risk policies and procedures that account for daily measurement of overall credit exposure to comply with counterparty credit limits, and monitoring and reporting of violations of counterparty credit limits performed by personnel that are independent of the business trading unit. *See also* 17 CFR 23.600(c)(1)(i), requiring the senior management and the governing body of each SD and MSP to review and approve credit risk tolerance limits for the SD or MSP.

[218] Proposed § 23.23(c)(2)(ii).

explained in the context of the SD de minimis threshold calculation,[219] the Commission believes that the swap positions of a non-U.S. person whose swap obligations are guaranteed by a U.S. person are identical, in relevant aspects, to those entered into directly by a U.S. person and thus present similar risks to the stability of the U.S. financial system or of U.S. entities. Although the default on that swap may not directly affect the U.S. guarantor on that swap, the default could affect the Guaranteed Entity's ability to meet its other obligations, for which the U.S. guarantor may also be liable. Treating Guaranteed Entities differently from U.S. persons could also create a substantial regulatory loophole, allowing transactions that have a similar connection to or impact on U.S. commerce to be treated differently depending on how the parties are structured and thereby undermining the effectiveness of the Dodd-Frank Act swap provisions and related Commission regulations.

The Commission is also proposing that a non-U.S. person must count swap positions with a Guaranteed Entity counterparty, except when the counterparty is registered as an SD.[220] The Commission notes that the guarantee of a swap is an integral part of the swap and that, as discussed above, counterparties may not be willing to enter into a swap with a Guaranteed Entity in the absence of the guarantee. The Commission also recognizes that, given the highly integrated corporate structures of global financial enterprises, financial groups may elect to conduct their swap activity in a number of different ways, including through a U.S. person or through a non-U.S. affiliate that

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[219] *See supra* section III.B.3.
[220] Proposed § 23.23(c)(2)(iii). The Commission notes that the proposed MSP provision does not include a provision for swap positions with non-U.S. persons guaranteed by a non-financial entity, similar to the carve-out in the proposed SD provision. *See* proposed § 23.23(b)(2)(iii)(*2*).

benefits from a guarantee from a U.S. person. Therefore, in order to avoid creating a substantial regulatory loophole, the Commission believes that swaps of a non-U.S. person with a counterparty whose obligations under the swaps are guaranteed by a U.S. person should receive the same treatment as swaps with a U.S. person.

However, similar to the discussion regarding SDs in section III.B.3, where a non-U.S. person (that itself is not a Guaranteed Entity or an SRS) enters into a swap with a Guaranteed Entity that is a registered SD, it is appropriate to permit the non-U.S. person not to count its swap position with the Guaranteed Entity against the non-U.S. person's MSP thresholds,[221] because one counterparty to the swap is a registered SD subject to comprehensive swap regulation and operating under the oversight of the Commission. For example, the swap position must be addressed in the SD's risk management program and account for, among other things, overall credit exposures to non-U.S. persons.[222] In addition, a non-U.S. person's swaps with a Guaranteed Entity that is an SD would be included in exposure calculations and attributed to the U.S. guarantor for purposes of determining whether the U.S. guarantor's swap exposures are systemically important on a portfolio basis and therefore require the protections provided by MSP registration. Therefore, in these circumstances, the Commission believes it is not necessary for the non-U.S. person to count such a swap position toward its MSP thresholds.

[221] Proposed § 23.23(c)(2)(iii).
[222] *See* 17 CFR 23.600(c)(4)(ii), requiring SDs and MSPs to have credit risk policies and procedures that account for daily measurement of overall credit exposure to comply with counterparty credit limits, and monitoring and reporting of violations of counterparty credit limits performed by personnel that are independent of the business trading unit. *See also* 17 CFR 23.600(c)(1)(i), requiring the senior management and the governing body of each SD and MSP to review and approve credit risk tolerance limits for the SD or MSP.

C. Attribution Requirement

In the Entities Rule, the Commission and the SEC provided a joint interpretation that an entity's swap positions in general would be attributed to a parent, other affiliate, or guarantor for purposes of the MSP analysis to the extent that the counterparties to those positions have recourse to the parent, other affiliate, or guarantor in connection with the position, such that no attribution would be required in the absence of recourse.[223] Even in the presence of recourse, however, the Commissions stated that attribution of a person's swap positions to a parent, other affiliate, or guarantor would not be necessary if the person is already subject to capital regulation by the Commission or the SEC or is a U.S. entity regulated as a bank in the United States (and is therefore subject to capital regulation by a prudential regulator).[224]

The Commission is proposing to address the cross-border application of the attribution requirement in a manner consistent with the Entities Rule and CEA section 2(i) and generally comparable to the approach adopted by the SEC.[225] Specifically, the Commission believes that the swap positions of an entity, whether a U.S. or non-U.S. person, should not be attributed to a parent, other affiliate, or guarantor for purposes of the MSP analysis in the absence of a guarantee. Even in the presence of a guarantee, attribution would not be required if the entity that entered into the swap directly is subject

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[223] *See* Entities Rule, 77 FR at 30689 (Stating that "an entity's swap . . . positions in general would be attributed to a parent, other affiliate or guarantor for purposes of the major participant analysis to the extent that the counterparties to those positions would have recourse to that other entity in connection with the position." The Commission stated further that "entities will be regulated as major participants when they pose a high level of risk in connection with the swap . . . positions they guarantee.").

[224] *Id.*

[225] *See* SEC Cross-Border Rule, 79 FR at 47346-48.

to capital regulation by the Commission or the SEC or is regulated as a bank in the United States.[226]

If a guarantee is present, however, and the entity being guaranteed is not subject to capital regulation (as described above), whether the attribution requirement would apply would depend on the U.S. person status of the person to whom there is recourse under the guarantee (*i.e.*, the U.S. person status of the guarantor). Specifically, a U.S. person guarantor would attribute to itself any swap position of an entity subject to a guarantee, whether a U.S. person or a non-U.S. person, for which the counterparty to the swap has recourse against that U.S. person guarantor. The Commission believes that when a U.S. person acts as a guarantor of a swap position, the guarantee creates risk within the United States of the type that MSP regulation is intended to address, regardless of the U.S. person status of the entity subject to a guarantee or its counterparty.[227]

A non-U.S. person would attribute to itself any swap position of an entity for which the counterparty to the swap has recourse against the non-U.S. person unless all relevant persons (*i.e.*, the non-U.S. person guarantor, the entity whose swap positions are guaranteed, and its counterparty) are non-U.S. persons that are not Guaranteed Entities. In this regard, the Commission believes that when a non-U.S. person provides a guarantee with respect to the swap position of a particular entity, the economic reality of the swap position is substantially identical, in relevant respects, to a position entered into directly by the non-U.S. person.

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[226] The Commission further clarifies that the swap positions of an entity that is required to register as an MSP, or whose MSP registration is pending, would not be subject to the attribution requirement.

[227] *See* Entities Rule, 77 FR at 30689 (attribution is intended to reflect the risk posed to the U.S. financial system when a counterparty to a position has recourse against a U.S. person).

In addition, the Commission believes that entities subject to a guarantee would be able to enter into significantly more swap positions (and take on significantly more risk) as a result of the guarantee than they would otherwise, amplifying the risk of the non-U.S. person guarantor's inability to carry out its obligations under the guarantee. Given the types of risk that MSP regulation is intended to address, the Commission has a strong regulatory interest in ensuring that the attribution requirement applies to non-U.S. persons that provide guarantees to U.S. persons and Guaranteed Entities. Accordingly, the Commission preliminarily believes that a non-U.S. person should be required to attribute to itself the swap positions of any entity for which it provides a guarantee unless it, the entity subject to the guarantee, and its counterparty are all non-U.S. persons that are not Guaranteed Entities.

D. Certain Exchange-Traded and Cleared Swaps

The Proposed Rule, consistent with its approach for SDs discussed above in section III.D, would allow a non-U.S. person that is not a Guaranteed Entity or an SRS to exclude from its MSP calculation any swap position that it anonymously enters into on a DCM, a registered SEF or a SEF exempted from registration by the Commission pursuant to section 5h(g) of the CEA, or an FBOT registered with the Commission pursuant to part 48 of its regulations,[228] if such swap is also cleared through a registered or exempt DCO.[229]

[228] The Commission would consider the proposed exception described herein also to apply with respect to an FBOT that provides direct access to its order entry and trade matching system from within the U.S. pursuant to no-action relief issued by Commission staff.
[229] Proposed § 23.23(d).

When a non-U.S. person enters into a swap position that is executed anonymously on a registered or exempt SEF, DCM, or registered FBOT, the Commission recognizes that the non-U.S. person would not have the necessary information about its counterparty to determine whether the swap position should be included in its MSP calculation. The Commission therefore believes that in this case the practical difficulties make it reasonable for the swap position to be excluded altogether.

The Proposed Rule is consistent with the Guidance, but would expand the exception to include SEFs and DCOs that are exempt from registration under the CEA, and also states that SRSs may not qualify for this exception. The CEA provides that the Commission may grant an exemption from registration if it finds that a foreign SEF or DCO is subject to comparable, comprehensive supervision and regulation by the appropriate governmental authorities in the SEF or DCO's home country.[230]

E. Request for Comment

The Commission invites comment on all aspects of the proposed cross-border application of the MSP registration threshold calculation described in sections IV.A through IV.D, and specifically requests comments on the following questions. Please explain your responses and provide alternatives to the relevant portions of the Proposed Rule, where applicable.

(23) Should the Commission modify its interpretation with regard to the attribution requirement to provide that attribution of a person's swap positions to a

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[230] *See* CEA sections 5h for the SEF exemption provision and 5b(h) for the DCO exemption provision. As discussed, *supra* note 201, the Commission recognizes that it recently issued proposed rulemakings regarding non-U.S. DCOs, and may modify this exception for exchange-traded and cleared swaps as necessary, based on any DCO-related proposed rules that are adopted by the Commission. .

parent, other affiliate, or guarantor would not be required if the person is subject to capital standards that are comparable to and as comprehensive as the capital regulations and oversight by the Commission, SEC, or a U.S. prudential regulator? If so, should the home country capital standards be deemed comparable and comprehensive if they are consistent in all respects with Basel III?

(24) Would it be appropriate to require a U.S. branch to include in its MSP threshold calculation all of its swap positions, as if they were swap positions of a U.S. person? Would it be appropriate to require an Other Non-U.S. Person to include in its MSP de minimis threshold calculation swaps conducted through a U.S. branch?

V. ANE Transactions

A. Background and Proposed Approach

The ANE Staff Advisory provided that a non-U.S. SD would generally be required to comply with transaction-level requirements for SDs for ANE Transactions.[231] In the January 2014 ANE Request for Comment, the Commission requested comments on all aspects of the ANE Staff Advisory, including: (1) the scope and meaning of the phrase "regularly arranging, negotiating, or executing" and what characteristics or factors distinguish "core, front-office" activity from other activities; and (2) whether the

[231] *See* ANE Staff Advisory. The ANE Staff Advisory represented the views of DSIO only, and not necessarily those of the Commission or any other office or division thereof. *See also* Guidance, 78 FR at 45333 (providing that the transaction-level requirements include: (1) required clearing and swap processing; (2) margining (and segregation) for uncleared swaps; (3) mandatory trade execution; (4) swap trading relationship documentation; (5) portfolio reconciliation and compression; (6) real-time public reporting; (7) trade confirmation; (8) daily trading records; and (9) external business conduct standards).

Commission should adopt the ANE Staff Advisory as Commission policy, in whole or in part.[232]

The Commission received seventeen comment letters in response to the ANE Request for Comment.[233] Most commenters emphasized that the risk associated with ANE Transactions lies outside the United States[234] and that non-U.S. SDs involve U.S. personnel primarily for the convenience of their global customers.[235] They also characterized the ANE Staff Advisory as impractical or unworkable, describing its key language ("regularly arranging, negotiating, or executing swaps" and "performing core, front-office activities") as vague, open to broad interpretation, and potentially capturing activities that are merely incidental to the swap transaction.[236] They further argued that if

[232] *See* ANE Request for Comment, 79 FR at 1348-49.

[233] Comments were submitted by the following entities: American Bankers Association Securities Association ("ABASA") (Mar. 10, 2014); Americans for Financial Reform ("AFR") (Mar. 10, 2014); Barclays Bank PLC ("Barclays") (Mar. 10, 2014); Chris R. Barnard (Mar. 8, 2014); Better Markets Inc. ("Better Markets") (Mar. 10, 2014); Coalition for Derivatives End-Users ("Coalition") (Mar. 10, 2014); Commercial Energy Working Group (Mar. 10, 2014); European Commission (Mar. 10, 2014); European Securities and Markets Authority ("ESMA") (Mar. 13, 2014); Institute for Agriculture and Trade Policy ("IATP") (Mar. 10, 2014); Institute of International Bankers ("IIB") (Mar. 10, 2014); International Swaps and Derivatives Association, Inc. ("ISDA") (Mar. 7, 2014); Investment Adviser Association ("IAA") (Mar. 10, 2014); Japan Financial Markets Council ("JFMC") (Mar. 4, 2014); Japanese Bankers Association ("JBA") (Mar. 7, 2014); Securities Industry and Financial Markets Association, Futures Industry Association, and Financial Services Roundtable ("SIFMA/FIA/FSR") (Mar. 10, 2014); Société Générale ("SG") (Mar. 10, 2014). The associated comment file is available at http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1452&ctl00_ctl00_cphContentMain_MainContent_gvCommentListChangePage=1_50. Although the comment file includes records of 22 comments, five were either duplicate submissions or not responsive to the ANE Request for Comment.

[234] *See, e.g.*, Barclays at 3 n.11; IIB at 4-5; ISDA at 6-7; SIFMA/FIA/FSR at 2, A-9–A-10; SG at 2 (adopting the ANE Staff Advisory would extend the Commission's regulations "to swaps whose risk lies totally offshore" and that do not pose a high risk to the U.S. financial system).

[235] *See, e.g.*, Coalition at 2 (non-U.S. SDs use U.S. personnel to arrange, negotiate, or execute swaps because they have particular subject matter expertise for or due to the location of their clients across time zone); European Commission at 1; IIB at 7-8 n.18; IAA at 2; ISDA at 4; JFMC at 2-3; SIFMA/FIA/FSR at A-4; SG at 3 (a non-U.S. SD may use salespersons in the United States if the ANE Transaction is linked to a USD instrument).

[236] *See, e.g.*, Barclays at 4-5; European Commission at 3 (whether negotiation of a master agreement by U.S. middle office staff would trigger application of the ANE Staff Advisory is unclear); IAA at 5 ("[T]he terms 'arranging' and 'negotiating' are overly broad and may encompass activities that are incidental to a

the ANE Staff Advisory were adopted as Commission policy, non-U.S. SDs would close U.S. branches and relocate personnel to other countries (or otherwise terminate agency contracts with U.S.-based agents) in order to avoid Dodd-Frank Act swap regulation or having to interpret and apply the ANE Staff Advisory, thereby increasing market fragmentation.[237] Two commenters addressed concerns regarding international comity and inconsistent, conflicting, or duplicative regimes, with one arguing that "it is of paramount importance to prevent the duplication of applicable rules to derivative transactions, in particular when the transactions have a strong local nature or only remote links with other jurisdictions, in order to support an efficient derivatives market[;]"[238] and the other saying that "[r]ules should therefore include the possibility to defer to those of the host regulator in most cases."[239]

A few commenters, however, supported the ANE Staff Advisory.[240] They argued that the Commission has jurisdiction over swap activities occurring in the United States[241] and expressed concern that the Commission's failure to assert such jurisdiction

swap transaction," such as providing market or pricing information); SIFMA/FIA/FSR at A-12 (arranging and negotiating trading relationships and legal documentation are "middle- and back-office operations" and should not be included); SG at 7-8 ("regularly" is an arbitrary concept that cannot be made workable, and programming trading systems to interpret "arranging, negotiating, or executing" on a trade-by-trade basis would not be feasible).

[237] *See, e.g.*, ABASA at 2 (adopting the ANE Staff Advisory would "impose unnecessary compliance burdens on swaps market participants, encourage them to re-locate jobs and activities outside the United States to accommodate non-U.S. client demands, and fragment market liquidity"); Coalition at 3 (emphasizing the impact on non-U.S. affiliates of U.S. end users, such as increased hedging costs and reduced access to registered counterparties); IIB at 7-8; ISDA at 4; JFMC at 3; SG at 8-9. *See also* IAA at 3 (expressing concern that non-U.S. clients may avoid hiring U.S. asset managers to avoid application of the ANE Staff Advisory).

[238] *See* ESMA at 1.

[239] *See* European Commission at 1.

[240] *See* AFR; Better Markets; IATP.

[241] *See* AFR at 2 (CEA section 2(i) clearly sets the statutory jurisdiction of CFTC rules to include all activities conducted inside the United States); Better Markets at 3 (the ANE Staff Advisory "represents the only reasonable interpretation of Congress's mandate to regulate swaps transactions with a 'direct and

would create a substantial loophole, allowing U.S. financial firms to operate in the United States without Dodd-Frank Act oversight by merely routing swaps through a non-U.S. affiliate.[242] They further argued that arranging, negotiating, or executing swaps are functions normally performed by brokers, traders, and salespersons and are economically central to the business of swap dealing.[243]

In addition to consideration of the foregoing comments, the Commission also considered a report the U.S. Treasury Department issued in October 2017, which expressed the view that the SEC and the CFTC should "reconsider the implications" of applying the Dodd-Frank Act requirements to certain transactions "merely on the basis that U.S.-located personnel arrange, negotiate, or execute the swap, especially for entities in comparably regulated jurisdictions."[244]

Based on the Commission's consideration of its experience under the Guidance, the comments it has received, respect for international comity, and the Commission's desire to focus its authority on potential significant risks to the U.S. financial system, the Commission has determined that ANE Transactions will not be considered a relevant

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significant connection with activities in, or effect on, commerce of the United States'"); IATP at 1 ("It should be self-evident that the swap activities in the United States of non-U.S. persons fall under the Commission's jurisdiction.").

[242] *See* AFR at 3 (failure to adopt the ANE Staff Advisory "could mean that U.S. firms operating in the U.S. would face different rules for the same transactions as compared to competitor firms also operating in the very same market and location, perhaps literally next door, who had arranged to route transactions through a nominally foreign subsidiary"); Better Markets at 3 (allowing registered SDs to book transactions overseas but otherwise handle the swap inside the United States would "create a gaping loophole," resulting in "keystroke off-shoring of the bookings, but otherwise the on-shoring of the core activities associated with the transaction").

[243] *See* AFR at 2-3, 5; Better Markets at 5 (brokers, structurers, traders, and salesmen "collectively comprise the general understanding of the core front office").

[244] *See* U.S. Department of Treasury, A Financial System That Creates Economic Opportunities: Capital Markets, at 133-36 (Oct. 2017), available at https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf.

factor for purposes of applying the Proposed Rule. Accordingly, under the Proposed Rule, all foreign-based swaps entered into between a non-U.S. swap entity and a non-U.S. person are treated the same regardless of whether the swap is an ANE Transaction. To the extent the Proposed Rule is finalized, this treatment would effectively supersede the ANE Staff Advisory with respect to the application of the group B and C requirements (discussed below) to ANE Transactions.

With respect to its experience, the Commission notes that the ANE No-Action Relief, which went into effect immediately after issuance of the ANE Staff Advisory, generally relieved non-U.S. swap entities from the obligation to comply with most transaction-level requirements when entering into swaps with most non-U.S. persons.[245] In the intervening period, the Commission has not found a negative impact on either its ability to effectively oversee non-US swap entities, nor the integrity and transparency of U.S. derivatives markets.

In the interest of international comity, under the Proposed Rule, as under the Guidance, swaps between certain non-U.S. persons would qualify for an exception from application of certain CFTC requirements.[246] ANE Transactions also involve swaps between non-U.S. persons, and thus the Commission has considered whether the U.S. aspect of ANE Transactions should override its general view that such transactions should qualify for the same relief. A person that, in connection with its dealing activity, engages in market-facing activity using personnel located in the United States is

[245] Specifically, non-U.S. persons that are neither guaranteed nor conduit affiliates, as described in the Guidance.
[246] Consisting of transaction-level requirements under the Guidance and group B and C requirements under the Proposed Rule, as discussed below.

conducting a substantial aspect of its dealing business in the United States. But, because the transactions involve two non-U.S. persons, and the financial risk of the transactions lies outside the United States, the Commission considers the extent to which the underlying regulatory objectives of the Dodd-Frank Act would be advanced in light of other policy considerations, including undue market distortions and international comity, when making the determination as to whether the Dodd-Frank Act swap requirements should apply to ANE Transactions.

As a preliminary matter, the Commission notes that the consequences of disapplication of the Dodd-Frank Act swap requirements would be mitigated in two respects. First, persons engaging in any aspect of swap transactions within the U.S. remain subject to the CEA and Commission regulations prohibiting the employment, or attempted employment, of manipulative, fraudulent, or deceptive devices, such as section 6(c)(1) of the CEA,[247] and Commission regulation 180.1.[248] The Commission thus would retain anti-fraud and anti-manipulation authority, and would continue to monitor the trading practices of non-U.S. persons that occur within the territory of the United States in order to enforce a high standard of customer protection and market integrity. Even where a swap is entered into by two non-U.S. persons, the United States has a significant interest in deterring fraudulent or manipulative conduct occurring within its borders and cannot be a haven for such activity.

Second, with respect to more specific regulation of swap dealing in accordance with the Commission's swap regime, the Commission notes that, in most cases, non-U.S.

[247] 7 U.S.C. 9(1).
[248] 17 CFR 180.1.

persons entering into ANE Transactions would be subject to regulation and oversight in their home jurisdictions similar to the Commission's transaction-level requirements as most of the major swap trading centers have implemented similar risk mitigation requirements.[249]

With respect to market distortion, the Commission gives weight to commenters that argued that application of transaction-level requirements to ANE Transactions would cause non-U.S. SDs to relocate personnel to other countries (or otherwise terminate agency contracts with U.S.-based agents) in order to avoid Dodd-Frank Act swap regulation or having to interpret and apply what the commenters considered a challenging ANE analysis, thereby potentially increasing market fragmentation.[250]

The Commission also gives weight to the regulatory interests of the home jurisdictions of non-U.S. persons engaged in ANE Transactions. Because the risk of the resulting swaps lies in those home countries and not the U.S. financial system, the Commission recognizes that, with the exception of enforcing the prohibition on fraudulent or manipulative conduct taking place in the United States, non-U.S. regulators will have a greater incentive to regulate the swap dealing activities of such non-U.S. persons – such as, for example, with respect to business conduct standards with counterparties, appropriate documentation, and recordkeeping. In these circumstances,

[249] *See* 2019 FSB Progress Report, Table M.
[250] *See, e.g.*, ABASA at 2 (adopting the ANE Staff Advisory would "impose unnecessary compliance burdens on swaps market participants, encourage them to re-locate jobs and activities outside the United States to accommodate non-U.S. client demands, and fragment market liquidity"); Coalition at 3 (emphasizing the impact on non-U.S. affiliates of U.S. end users, such as increased hedging costs and reduced access to registered counterparties); IIB at 7-8; ISDA at 4; JFMC at 3; SG at 8-9. *See also* IAA at 3 (expressing concern that non-U.S. clients may avoid hiring U.S. asset managers to avoid application of the ANE Staff Advisory).

where the risk lies outside the U.S. financial system, the Commission recognizes the greater supervisory interest of the authorities in the home jurisdictions of the non-U.S. persons. The Commission is also not aware of any major swap regulatory jurisdiction that applies its regulatory regime to U.S. entities engaging in ANE Transactions within its territory.

In sum, the Commission has determined that the mitigating effect of the anti-fraud and anti-manipulation authority retained by the Commission and the prevalence of applicable regulatory requirements similar to the Commission's own, the likelihood of disruptive avoidance, the Commission's respect for the regulatory interests of the foreign jurisdictions where the actual financial risks of ANE Transactions lie in accordance with the principles of international comity, and the awareness that application of its swap requirements in the ANE context would make the Commission an outlier among the major swap regulatory jurisdictions, outweighs the Commission's regulatory interest in applying its swap requirements to ANE Transactions differently than such are otherwise proposed to be applied to swaps between Other Non-U.S. Persons.

B. Request for Comment

The Commission invites comment on all aspects of the proposed treatment of ANE Transactions described in section V, and specifically requests comments on the following questions. Please explain your responses and provide alternatives to the Proposed Rule, where applicable.

(25) Should the Commission apply certain transaction-level requirements (e.g., § 23.433 (fair dealing)) to SDs and MSPs with respect to ANE Transactions, or are the

existing anti-fraud and anti-manipulation powers under the CEA and Commission regulations adequate safeguards to address any wrongdoing arising from ANE Transactions.

(26) Should the Commission consider adopting a territorial approach similar to the SEC, where non-US counterparties engaging in ANE Transactions would count such transactions towards their de minimis thresholds and be subject to certain transaction-level requirements,[251] rather than the proposed comity-based approach of excluding ANE Transactions from the Proposed Rule?

VI. Proposed Exceptions from Group B and Group C Requirements, Substituted Compliance for Group A and Group B Requirements, and Comparability Determinations

Title VII of the Dodd-Frank Act and Commission regulations thereunder establish a broad range of requirements applicable to SDs and MSPs, including requirements regarding risk management and internal and external business conduct. These requirements are designed to reduce systemic risk, increase counterparty protections, and increase market efficiency, orderliness, and transparency.[252] Consistent with the Guidance,[253] SDs and MSPs (whether or not U.S. persons) are subject to all of the

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[251] *See* Security-Based Swap Transactions Connected with a Non-U.S. Person's Dealing Activity That Are Arranged, Negotiated, or Executed by Personnel Located in a U.S. Branch or Office or Security-Based Swap Dealer De Minimis Exception, 81 FR 8598 (Feb. 19, 2016); Proposed Rule Amendments and Guidance Addressing Cross-Border Application of Certain Security-Based Swap Requirements, 84 FR 24206 (May 24, 2019).
[252] *See, e.g.*, Entities Rule, 77 FR at 30629, 30703.
[253] *See* Guidance, 78 FR at 45342. The Commission notes that while the Guidance states that all swap entities (wherever located) are subject to all of the CFTC's Title VII requirements, the Guidance went on to describe how and when the Commission would expect swap entities to comply with specific requirements and when substituted compliance would be available under its non-binding framework.

Commission regulations described below by virtue of their status as Commission registrants. Put differently, the Commission's view is that if an entity is required to register as an SD or MSP under the Commission's interpretation of section 2(i) of the CEA, then such entity should be subject to these regulations with respect to all of its swap activities. As explained further below, such an approach is necessary because of the important role that the SD and MSP requirements play in the proper operation of a registrant.

However, consistent with section 2(i) of the CEA, in the interest of international comity, and for other reasons discussed in this release, the Commission is proposing exceptions from, and a substituted compliance process for, certain regulations applicable to registered SDs and MSPs, as appropriate.[254] Further, the Proposed Rule would create a framework for comparability determinations that emphasizes a holistic, outcomes-based approach that is grounded in principles of international comity.

A. Classification and Application of Certain Regulatory Requirements – Group A, Group B, and Group C Requirements

The Guidance applied a bifurcated approach to the classification of certain regulatory requirements applicable to SDs and MSPs, based on whether the requirement

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[254] The Commission intends to separately address the cross-border application of the Title VII requirements addressed in the Guidance that are not discussed in this release (*e.g.*, capital adequacy, clearing and swap processing, mandatory trade execution, swap data repository reporting, large trader reporting, and real-time public reporting). With respect to capital adequacy requirements for SDs and MSPs, the Commission notes that it has proposed but not yet adopted final regulations. *See* the Commission's proposed capital adequacy regulations in Capital Requirements of Swap Dealers and Major Swap Participants, 84 FR 69664 (proposed Dec. 19, 2019); Capital Requirements of Swap Dealers and Major Swap Participants, 81 FR 91252 (proposed Dec. 16, 2016); and Capital Requirements of Swap Dealers and Major Swap Participants, 76 FR 27802 (proposed May 12, 2011).

applies to the firm as a whole ("Entity-Level Requirement" or "ELR") or to the individual swap or trading relationship ("Transaction-Level Requirement" or "TLR").[255]

The Guidance categorized the following regulatory requirements as ELRs: (1) capital adequacy; (2) chief compliance officer; (3) risk management; (4) swap data recordkeeping; (5) swap data repository ("SDR") reporting; and (6) large trader reporting.[256] The Guidance further divided ELRs into two subcategories.[257] The first category of ELRs includes: (1) capital adequacy; (2) chief compliance officer; (3) risk management; and (4) certain swap data recordkeeping requirements[258] ("First Category ELRs").[259] The second category of ELRs includes: (1) SDR reporting; (2) certain aspects of swap data recordkeeping relating to complaints and marketing and sales materials under §§ 23.201(b)(3) and 23.201(b)(4); and (3) large trader reporting ("Second Category ELRs").[260]

The Guidance categorized the following regulatory requirements as TLRs: (1) required clearing and swap processing; (2) margin (and segregation) for uncleared swaps; (3) mandatory trade execution; (4) swap trading relationship documentation; (5) portfolio reconciliation and compression; (6) real-time public reporting; (7) trade confirmation; (8) daily trading records; and (9) external business conduct standards.[261] As with the ELRs,

[255] *See, e.g.,* Guidance, 78 FR at 45331.
[256] *See, e.g., id.*
[257] *See, e.g., id.*
[258] Swap data recordkeeping under 17 CFR 23.201 and 23.203 (except certain aspects of swap data recordkeeping relating to complaints and sales materials).
[259] *See, e.g.,* Guidance, 78 FR at 45331.
[260] *See, e.g., id.*
[261] *See, e.g., id.* at 45333.

the Guidance similarly subdivided TLRs into two subcategories.[262] The Commission determined that all TLRs, other than external business conduct standards, address risk mitigation and market transparency.[263] Accordingly, under the Guidance, all TLRs except external business conduct standards are classified as "Category A TLRs," whereas external business conduct standards are classified as "Category B TLRs."[264] Under the Guidance, generally, whether a specific Commission requirement applies to a swap entity and a swap and whether substituted compliance is available depends on the classification of the requirement as an ELR or TLR and the sub-classification of each and the type of swap entity and, in certain cases, the counterparty to a specific swap.[265]

To avoid confusion that may arise from using the ELR/TLR classification in the Proposed Rule, given that the Proposed Rule does not address the same set of Commission regulations as the Guidance, the Commission is proposing to classify certain of its regulations as group A, group B, and group C requirements for purposes of determining the availability of certain exceptions from, and/or substituted compliance for, such regulations. A description of each of the group A requirements, group B requirements, and group C requirements is below.

1. Group A Requirements

The group A requirements include: (1) chief compliance officer; (2) risk management; (3) swap data recordkeeping; and (4) antitrust considerations. Specifically, the group A requirements consist of the requirements set forth in §§ 3.3, 23.201, 23.203,

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[262] *See, e.g., id.*
[263] *See, e.g., id.*
[264] *See, e.g., id.*
[265] *See, e.g., id.* at 45337-38.

23.600, 23.601, 23.602, 23.603, 23.605, 23.606, 23.607, and 23.609,[266] each discussed below. The Commission believes that these requirements would be impractical to apply only to specific transactions or counterparty relationships, and are most effective when applied consistently across the entire enterprise. They ensure that swap entities implement and maintain a comprehensive and robust system of internal controls to ensure the financial integrity of the firm, and, in turn, the protection of the financial system. Together with other Commission requirements, they constitute an important line of defense against financial, operational, and compliance risks that could lead to a firm's default. Requiring swap entities to rigorously monitor and address the risks they incur as part of their day-to-day businesses lowers the registrants' risk of default – and ultimately protects the public and the financial system. For this reason, the Commission has strong supervisory interests in ensuring that swap entities (whether domestic or foreign) are subject to the group A requirements or comparably rigorous standards.

(i) Chief compliance officer

Section 4s(k) of the CEA requires that each SD and MSP designate an individual to serve as its chief compliance officer ("CCO") and specifies certain duties of the CCO.[267] Pursuant to section 4s(k), the Commission adopted § 3.3,[268] which requires SDs and MSPs to designate a CCO responsible for administering the firm's compliance

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[266] 17 CFR 3.3, 23.201, 23.203, 23.600, 23.601, 23.602, 23.603, 23.605, 23.606, 23.607, and 23.609.
[267] 7 U.S.C. 6s(k).
[268] 17 CFR 3.3. *See* Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants, 77 FR 20128 (Apr. 3, 2012) ("Final SD and MSP Recordkeeping, Reporting, and Duties Rule"). In 2018, the Commission adopted amendments to the CCO requirements. *See* Chief Compliance Officer Duties and Annual Report Requirements for Futures Commission Merchants, Swap Dealers, and Major Swap Participants, 83 FR 43510 (Aug. 27, 2018).

policies and procedures, reporting directly to the board of directors or a senior officer of the SD or MSP, as well as preparing and filing with the Commission a certified annual report discussing the registrant's compliance policies and activities. The CCO function is an integral element of a firm's risk management and oversight and the Commission's effort to foster a strong culture of compliance within SDs and MSPs.

(ii) Risk management

Section 4s(j) of the CEA requires each SD and MSP to establish internal policies and procedures designed to, among other things, address risk management, monitor compliance with position limits, prevent conflicts of interest, and promote diligent supervision, as well as maintain business continuity and disaster recovery programs.[269] The Commission implemented these provisions in §§ 23.600, 23.601, 23.602, 23.603, 23.605, and 23.606.[270] The Commission also adopted § 23.609,[271] which requires certain risk management procedures for SDs or MSPs that are clearing members of a DCO.[272] Collectively, these requirements help to establish a comprehensive internal risk management program for SDs and MSPs, which is critical to effective systemic risk management for the overall swap market.

[269] 7 U.S.C. 6s(j).

[270] 17 CFR 23.600, 23.601, 23.602, 23.603, 23.605, and 23.606. *See* Final SD and MSP Recordkeeping, Reporting, and Duties Rule, 77 FR 20128 (addressing rules related to risk management programs, monitoring of position limits, diligent supervision, business continuity and disaster recovery, conflicts of interest policies and procedures, and general information availability).

[271] 17 CFR 23.609.

[272] *See* Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 FR 21278 (Apr. 9, 2012).

(iii) Swap data recordkeeping

CEA section 4s(f)(1)(B) requires SDs and MSPs to keep books and records for all activities related to their swap business.[273] Sections 4s(g)(1) and (4) require SDs and MSPs to maintain trading records for each swap and all related records, as well as a complete audit trail for comprehensive trade reconstructions.[274] Additionally, CEA section 4s(f)(1) requires SDs and MSPs to "make such reports as are required by the Commission by rule or regulation regarding the transactions and positions and financial condition of" the registered SD or MSP.[275] Further, CEA section 4s(h) requires SDs and MSPs to "conform with such business conduct standards … as may be prescribed by the Commission by rule or regulation."[276]

Pursuant to these provisions, the Commission promulgated final rules that set forth certain reporting and recordkeeping for SDs and MSPs.[277] Specifically, §§ 23.201 and 23.203[278] require SDs and MSPs to keep records including complete transaction and position information for all swap activities, including documentation on which trade information is originally recorded. In particular, § 23.201 states that each SD and MSP shall keep full, complete, and systematic records of all activities related to its business as a SD or MSP.[279] Such records must include, among other things, a record of each complaint received by the SD or MSP concerning any partner, member, officer,

[273] 7 U.S.C. 6s(f)(1)(B).
[274] 7 U.S.C. 6s(g)(1) and (4).
[275] 7 U.S.C. 6s(f)(1).
[276] 7 U.S.C. 6s(h)(1). *See* 7 U.S.C. 6s(h)(3).
[277] *See* Final SD and MSP Recordkeeping, Reporting, and Duties Rule, 77 FR 20128.
[278] 17 CFR 23.201 and 203.
[279] 17 CFR 23.201(b).

employee, or agent,[280] as well as all marketing and sales presentations, advertisements, literature, and communications.[281] Commission regulation 23.203[282] requires, among other things, that records (other than swap data reported in accordance with part 45 of the Commission's regulations[283]) be maintained in accordance with § 1.31.[284] Commission regulation 1.31 requires that records relating to swaps be maintained for specific durations, including that records of swaps be maintained for a minimum of five years and as much as the life of the swap plus five years, and that most records be "readily accessible" for the entire record keeping period.[285]

(iv) Antitrust Considerations

Section 4s(j)(6) of the CEA prohibits an SD or MSP from adopting any process or taking any action that results in any unreasonable restraint of trade or imposes any material anticompetitive burden on trading or clearing, unless necessary or appropriate to achieve the purposes of the CEA.[286] The Commission promulgated this requirement in § 23.607(a)[287] and also adopted § 23.607(b), which requires SDs and MSPs to adopt policies and procedures to prevent actions that result in unreasonable restraints of trade or impose any material anticompetitive burden on trading or clearing.[288]

[280] 17 CFR 23.201(b)(3)(i).
[281] 17 CFR 23.201(b)(4).
[282] 17 CFR 23.203.
[283] 17 CFR 45.
[284] 17 CFR 1.31.
[285] 17 CFR 1.31(b).
[286] 7 U.S.C. 6s(j)(6).
[287] 17 CFR 23.607(a).
[288] 17 CFR 23.607(b).

2. Group B Requirements

The group B requirements include: (1) swap trading relationship documentation; (2) portfolio reconciliation and compression; (3) trade confirmation; and (4) daily trading records. Specifically, the group B requirements consist of the requirements set forth in §§ 23.202, 23.501, 23.502, 23.503, and 23.504,[289] each discussed below. The group B requirements relate to risk mitigation and the maintenance of good recordkeeping and business practices.[290] Unlike the group A requirements, the Commission believes that the group B requirements can practically be applied on a bifurcated basis between domestic and foreign transactions or counterparty relationships and, thus, do not need to be applied uniformly across an entire enterprise. This allows the Commission to have greater flexibility with respect to the application of these requirements to non-U.S. swap entities and foreign branches of U.S. swap entities.

(i) Swap trading relationship documentation

CEA section 4s(i) requires each SD and MSP to conform to Commission standards for the timely and accurate confirmation, processing, netting, documentation, and valuation of swaps.[291] Pursuant to section 4s(i), the Commission adopted, among

[289] 17 CFR 23.202, 23.501, 23.502, 23.503, and 23.504.

[290] *See, e.g.*, Int'l Org. of Sec. Comm'ns, Risk Mitigation Standards for Non-Centrally Cleared OTC Derivatives, IOSCO Doc. FR01/2015 (Jan. 28, 2015) ("IOSCO Risk Management Standards"), available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD469.pdf (discussing, among other things, the objectives and benefits of trading relationship documentation, trade confirmation, reconciliation, and portfolio compression requirements). In addition, the group B requirements also provide customer protection and market transparency benefits.

[291] 7 U.S.C. 6s(i).

other regulations, § 23.504.[292] Regulation 23.504(a) requires SDs and MSPs to "establish, maintain and follow written policies and procedures" to ensure that the SD or MSP executes written swap trading relationship documentation, and § 23.504(c) requires that documentation policies and procedures be audited periodically by an independent auditor to identify material weaknesses.[293] Under § 23.504(b), the swap trading relationship documentation must include, among other things: (1) all terms governing the trading relationship between the SD or MSP and its counterparty; (2) credit support arrangements; (3) investment and re-hypothecation terms for assets used as margin for uncleared swaps; and (4) custodial arrangements.[294] Swap documentation standards facilitate sound risk management and may promote standardization of documents and transactions, which are key conditions for central clearing, and lead to other operational efficiencies, including improved valuation.

(ii) Portfolio reconciliation and compression

CEA section 4s(i) directs the Commission to prescribe regulations for the timely and accurate processing and netting of all swaps entered into by SDs and MSPs.[295] Pursuant to CEA section 4s(i), the Commission adopted §§ 23.502 and 23.503,[296] which require SDs and MSPs to perform portfolio reconciliation and compression, respectively,

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[292] 17 CFR 23.504. *See* Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 FR 55904 (Sept. 11, 2012) ("Final Confirmation, Risk Mitigation, and Documentation Rules").

[293] 17 CFR 23.504(a)(2) and (c).

[294] 17 CFR 23.504(b).

[295] 7 U.S.C. 6s(i).

[296] 17 CFR 23.502 and 503. *See* Final Confirmation, Risk Mitigation, and Documentation Rules, 77 FR 55904.

for their swaps.[297] Portfolio reconciliation is a post-execution risk management tool designed to ensure accurate confirmation of a swap's terms and to identify and resolve any discrepancies between counterparties regarding the valuation of the swap. Portfolio compression is a post-trade processing and netting mechanism that is intended to ensure timely, accurate processing and netting of swaps.[298] Further, § 23.503 requires all SDs and MSPs to establish policies and procedures for terminating fully offsetting uncleared swaps, when appropriate, and periodically participating in bilateral and/or multilateral portfolio compression exercises for uncleared swaps with other SDs or MSPs or through a third party.[299] The rule also requires policies and procedures for engaging in such exercises for uncleared swaps with non-SDs and non-MSPs upon request.[300]

(iii) Trade confirmation

Section 4s(i) of the CEA requires that each SD and MSP must comply with the Commission's regulations prescribing timely and accurate confirmation of swaps.[301] The Commission adopted § 23.501,[302] which requires, among other things, timely and accurate confirmation of swap transactions (which includes execution, termination, assignment, novation, exchange, transfer, amendment, conveyance, or extinguishing of rights or obligations of a swap) among SDs and MSPs by the end of the first business day following the day of execution.[303] Timely and accurate confirmation of swaps – together

[297] *See* 17 CFR 23.502 and 503.
[298] For example, the reduced transaction count may decrease operational risk as there are fewer trades to maintain, process, and settle.
[299] *See* 17 CFR 23.503(a).
[300] 17 CFR 23.503(b).
[301] 7 U.S.C. 6s(i).
[302] 17 CFR 23.501. *See* Final Confirmation, Risk Mitigation, and Documentation Rules, 77 FR 55904.
[303] 17 CFR 23.501(a)(1).

with portfolio reconciliation and compression – are important post-trade processing mechanisms for reducing risks and improving operational efficiency.[304]

(iv) Daily trading records

Pursuant to CEA section 4s(g),[305] the Commission adopted § 23.202,[306] which requires SDs and MSPs to maintain daily trading records, including records of trade information related to pre-execution, execution, and post-execution data that is needed to conduct a comprehensive and accurate trade reconstruction for each swap. The regulation also requires that records be kept of cash or forward transactions used to hedge, mitigate the risk of, or offset any swap held by the SD or MSP.[307] Accurate and timely records regarding all phases of a swap transaction can serve to greatly enhance a firm's internal supervision, as well as the Commission's ability to detect and address market or regulatory abuses or evasion.

3. Group C Requirements

Pursuant to CEA section 4s(h),[308] the Commission adopted external business conduct rules, which establish certain additional business conduct standards governing the conduct of SDs and MSPs in dealing with their swap counterparties.[309] The group C requirements are set forth in §§ 23.400-451.[310] Broadly speaking, these rules are

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[304] Additionally, the Commission notes that § 23.504(b)(2) requires that the swap trading relationship documentation of SDs and MSPs must include all confirmations of swap transactions. 17 CFR 23.504(b)(2).
[305] 7 U.S.C. 6s(g).
[306] 17 CFR 23.202. *See* Final SD and MSP Recordkeeping, Reporting, and Duties Rule, 77 FR 20128.
[307] 17 CFR 23.202(b).
[308] 7 U.S.C. 6s(h).
[309] *See* Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 77 FR 9734 (Feb. 17, 2012).
[310] 17 CFR 23.400-451.

designed to enhance counterparty protections by establishing robust requirements regarding SDs' and MSPs' conduct with their counterparties. Under these rules, SDs and MSPs are required to, among other things, conduct due diligence on their counterparties to verify eligibility to trade (including eligible contract participant status), refrain from engaging in abusive market practices, provide disclosure of material information about the swap to their counterparties, provide a daily mid-market mark for uncleared swaps, and, when recommending a swap to a counterparty, make a determination as to the suitability of the swap for the counterparty based on reasonable diligence concerning the counterparty.

In the Commission's view, the group C requirements focus on customer protection and have a more attenuated link to, and are therefore distinguishable from, systemic and market-oriented protections in the group A and group B requirements. Additionally, as discussed below, the Commission believes that the foreign jurisdictions in which non-U.S. persons and foreign branches of U.S. swap entities are located are likely to have a significant interest in the type of business conduct standards that would be applicable to transactions with such non-U.S. persons and foreign branches within their jurisdiction, and, consistent with section 2(i) of the CEA and in the interest of international comity, it is generally appropriate to defer to such jurisdictions in applying, or not applying, such standards to foreign-based swaps with foreign counterparties.

4. Request for Comment

The Commission invites comment on all aspects of the Proposed Rule, including the classifications of Title VII requirements discussed above, and specifically requests comments on the following questions. Please explain your responses and provide alternatives to the relevant portions of the Proposed Rule, where applicable.

(27) On the classification of group A, group B, and group C requirements, should the Commission use these classifications, revert to the ELR and TLR classifications used in the Guidance, or otherwise classify the relevant Title VII requirements?

(28) To the extent that you agree with the Commission's proposed use of the group A, group B, and group C requirements classification, should any of the requirements be re-classified or removed from such groups? Should requirements not included of any of the groups be added to any of them? If so, which requirements?

B. Proposed Exceptions

Consistent with section 2(i) of the CEA, the Commission is proposing four exceptions from certain Commission regulations for foreign-based swaps in the Proposed Rule.

First, the Commission is proposing an exception from certain group B and C requirements for certain anonymous, exchange-traded, and cleared foreign-based swaps ("Exchange-Traded Exception").

Second, the Commission is proposing an exception from the group C requirements for certain foreign-based swaps with foreign counterparties ("Foreign Swap Group C Exception").

Third, the Commission is proposing an exception from the group B requirements for the foreign-based swaps of certain non-U.S. swap entities with certain foreign counterparties ("Non-U.S. Swap Entity Group B Exception").

Fourth, the Commission is proposing an exception from the group B requirements for certain foreign-based swaps of foreign branches of U.S. swap entities with certain foreign counterparties, subject to certain limitations, including a quarterly cap on the amount of such swaps ("Foreign Branch Group B Exception").

While these exceptions each have different eligibility requirements discussed below, a common requirement is that they would be available only to foreign-based swaps. As discussed in section II.G above, under the Proposed Rule, a foreign-based swap would mean: (1) a swap by a non-U.S. swap entity, except for a swap conducted through a U.S. branch; or (2) a swap conducted through a foreign branch. Under the Proposed Rule, swaps that do not meet these requirements would be treated as domestic swaps for purposes of applying the group B and group C requirements and, therefore, would not be eligible for the above exceptions.

Pursuant to the Proposed Rule, swap entities that avail themselves of these exceptions for their foreign-based swaps would only be required to comply with the applicable laws of the foreign jurisdiction(s) to which they are subject, rather than the relevant Commission requirements, for such swaps. However, the Commission notes that, notwithstanding these exceptions, swap entities would remain subject to the CEA and Commission regulations not covered by the exceptions, including the prohibition on the employment, or attempted employment, of manipulative and deceptive devices in

§ 180.1 of the Commission's regulations.[311] In addition, the Commission would expect swap entities to address any significant risk that may arise as a result of the utilization of one or more exceptions in their risk management programs required pursuant to § 23.600.[312]

1. Exchange-Traded Exception

The Commission is proposing that, with respect to its foreign-based swaps, each non-U.S. swap entity and foreign branch of a U.S. swap entity would be excepted from the group B requirements (other than the daily trading records requirements in §§ 23.202(a) through 23.202(a)(1)[313]) and the group C requirements with respect to any swap entered into on a DCM, a registered SEF or a SEF exempted from registration by the Commission pursuant to section 5h(g) of the CEA, or an FBOT registered with the Commission pursuant to part 48 of its regulations[314] where, in each case, the swap is cleared through a registered DCO or a clearing organization that has been exempted from registration by the Commission pursuant to section 5b(h) of the CEA, and the swap entity does not know the identity of the counterparty to the swap prior to execution.[315]

[311] 17 CFR 180.1.

[312] 17 CFR 23.600.

[313] 17 CFR 23.202(a) through (a)(1).

[314] The Commission would consider the proposed exception described herein also to apply with respect to an FBOT that provides direct access to its order entry and trade matching system from within the U.S. pursuant to no-action relief issued by Commission staff.

[315] Proposed § 23.23(e)(1)(i). This approach is similar to the Guidance. *See* Guidance, 78 FR at 45351-52 and 45360-61. As discussed in the Guidance and below, the Commission recognizes that certain of the group B requirements and group C requirements are not applicable to swaps meeting the requirements of the exception in any event. However, the Commission nonetheless wishes to expressly provide that the swaps described in the exception are excepted from all of the group B and group C requirements, other than §§ 23.302(a) through (a)(1) as discussed below. As discussed, *supra* note 201, the Commission recognizes that it recently issued proposed rulemakings regarding non-U.S. DCOs, and may modify this exception for exchange-traded and cleared swaps as necessary, based on any DCO-related proposed rules that are adopted by the Commission.

With respect to the group B trade confirmation requirement, the Commission notes that where a cleared swap is executed anonymously on a DCM or SEF (as discussed above), independent requirements that apply to DCM and SEF transactions pursuant to the Commission's regulations should ensure that these requirements are met.[316] And, for a combination of reasons, including the fact that a registered FBOT is analogous to a DCM and is expected to be subject to comprehensive supervision and regulation in its home country,[317] and the fact that the swap will be cleared, the Commission believes that the Commission's trade confirmation requirements should not apply to foreign-based swaps that meet the requirements of the exception and are traded on registered FBOTs.

Of the remaining group B requirements, the portfolio reconciliation and compression and swap trading relationship documentation requirements would not apply to cleared DCM, SEF, or FBOT transactions described above because the Commission regulations that establish those requirements make clear that they do not apply to cleared transactions.[318] For the last group B requirement – the daily trading records

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[316] *See* 17 CFR 23.501(a)(4)(i) ("Any swap transaction executed on a swap execution facility or designated contract market shall be deemed to satisfy the requirements of this section, provided that the rules of the swap execution facility or designated contract market establish that confirmation of all terms of the transactions shall take place at the same time as execution."); and 37.6(b) ("A swap execution facility shall provide each counterparty to a transaction that is entered on or pursuant to the rules of the swap execution facility with a written record of all of the terms of the transaction which shall legally supersede any previous agreement and serve as confirmation of the transaction. The confirmation of all terms shall take place at the same time as execution …").

[317] Pursuant to 17 CFR 48.5(d)(2), in reviewing the registration application of an FBOT, the Commission will consider whether the FBOT and its clearing organization are subject to comprehensive supervision and regulation by the appropriate governmental authorities in their home country or countries that is comparable to the comprehensive supervision and regulation to which DCMs and DCOs are respectively subject under the Act, Commission regulations, and other applicable United States laws and regulations.

[318] *See* 17 CFR 23.502(d) ("Nothing in this section [portfolio reconciliation] shall apply to a swap that is cleared by a derivatives clearing organization"); 23.503(c) ("Nothing in this section [portfolio compression]

requirement[319] – the Commission believes that, as a matter of international comity and recognizing the supervisory interests of foreign regulators who may have their own trading records requirements, it is appropriate to except such foreign-based swaps from certain of the Commission's daily trading records requirements. However, the Commission believes that the requirements of §§ 23.202(a) through (a)(1) should continue to apply, as it believes that all swap entities should be required to maintain, among other things, sufficient records to conduct a comprehensive and accurate trade reconstruction for each swap. The Commission notes that, in particular, for certain pre-execution trade information under § 23.202(a)(1),[320] the swap entity may be the best, or only, source for such records. For this reason, paragraphs (a) through (a)(1) of § 23.202 are carved out from the group B requirements in the proposed exception.

Additionally, given that this exception is predicated on anonymity, many of the group C requirements would be inapplicable.[321] In the interest of international comity

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shall apply to a swap that is cleared by a derivatives clearing organization."); and 23.504(a)(1)(iii) ("The requirements of this section [swap trading relationship documentation] shall not apply to … [s]waps cleared by a derivatives clearing organization.").

[319] *See* 17 CFR 23.202.

[320] *See* 17 CFR 23.202(a)(1).

[321] *See* 17 CFR 23.402(b)-(c) (requiring SDs and MSPs to obtain and retain certain information only about each counterparty "whose identity is known to the SD or MSP prior to the execution of the transaction"); 23.430(e) (not requiring SDs and MSPs to verify counterparty eligibility when a transaction is entered on a DCM or SEF and the SD or MSP does not know the identity of the counterparty prior to execution); 23.431(c) (not requiring disclosure of material information about a swap if initiated on a DCM or SEF and the SD or MSP does not know the identity of the counterparty prior to execution); 23.450(h) (not requiring SDs and MSPs to have a reasonable basis to believe that a Special Entity has a qualified, independent representative if the transaction with the Special Entity is initiated on a DCM or SEF and the SD or MSP does not know the identity of the Special Entity prior to execution); and 23.451(b)(2)(iii) (disapplying the prohibition on entering into swaps with a governmental Special Entity within two years after any contribution to an official of such governmental Special Entity if the swap is initiated on a DCM or SEF and the SD or MSP does not know the identity of the Special Entity prior to execution). Because the Commission believes a registered FBOT is analogous to a DCM for these purposes and is expected to be subject to comprehensive supervision and regulation in its home country, and because a SEF that is exempted from registration by the Commission pursuant to section 5h(g) of the CEA must be subject to

and because the proposed exception requires that the swap be exchange-traded and cleared, the Commission is proposing that foreign-based swaps also be excepted from the remaining group C requirements in these circumstances. The Commission expects that the requirements that the swaps be exchange-traded and cleared will generally limit swaps that benefit from the exception to standardized and commonly-traded, foreign-based swaps, for which the Commission believes application of the remaining group C requirements is not necessary.

2. Foreign Swap Group C Exception

The Commission is also proposing that each non-U.S. swap entity and foreign branch of a U.S. swap entity would be excepted from the group C requirements with respect to its foreign-based swaps with a foreign counterparty.[322] Such swaps would not include as a party a U.S. person (other than a foreign branch where the swap is conducted through such foreign branch) or be conducted through a U.S. branch. Given that the group C requirements are intended to promote counterparty protections in the context of local market sales practices, the Commission recognizes that foreign regulators may have a relatively stronger supervisory interest in regulating such swaps in relation to the group

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supervision and regulation that is comparable to that to which Commission-registered SEFs are subject, the Commission is also proposing that these group C requirements would not be applicable where such a swap is executed anonymously on a registered FBOT, or a SEF that has been exempted from registration with the Commission pursuant to section 5h(g) of the CEA, and cleared.

[322] Proposed § 23.23(e)(1)(ii) This approach is similar to the Guidance. *See* Guidance, 78 FR at 45360-61. As discussed in section II.G, under the Proposed Rule, a foreign counterparty would mean: (1) a non-U.S. person, except with respect to a swap conducted through a U.S. branch of that non-U.S. person; or (2) a foreign branch where it enters into a swap in a manner that satisfies the definition of a swap conducted through a foreign branch.

As used herein, the term swap includes transactions in swaps as well as swaps that are offered but not entered into, as applicable.

C requirements. Accordingly, the Commission believes that applying the group C requirements to these transactions may not be warranted.[323]

The Commission notes that, just as the Commission has a strong supervisory interest in regulating and enforcing the group C requirements associated with swaps taking place in the United States, foreign regulators would have a similar interest in overseeing sales practices for swaps occurring within their jurisdictions. Further, given the scope of section 2(i) of the CEA with respect to the Commission's regulation of swap activities outside the United States, the Commission believes that imposing its group C requirements on a foreign-based swap between a non-U.S. swap entity or foreign branch of a U.S. swap entity, on one hand, and a foreign counterparty, on the other, is generally not necessary to advance the customer protection goals of the Dodd-Frank Act embodied in the group C requirements.

On the other hand, whenever a swap involves at least one party that is a U.S. person (other than a foreign branch where the swap is conducted through such foreign branch) or is a swap that is conducted through a U.S. branch, the Commission believes it has a strong supervisory interest in regulating and enforcing the group C requirements. A major purpose of Title VII is to control the potential harm to U.S. markets that can arise from risks that are magnified or transferred between parties via swaps. Exercise of U.S. jurisdiction with respect to the group C requirements over such swaps is a reasonable

[323] The Commission expressed a similar view in the Guidance. *See* Guidance, 78 FR at 45360-61.

exercise of jurisdiction because of the strong U.S. interest in minimizing the potential risks that may flow to the U.S. economy as a result of such swaps.[324]

3. Non-U.S. Swap Entity Group B Exception

The Commission is also proposing that each non-U.S. swap entity that is an Other Non-U.S. Person would be excepted from the group B requirements with respect to any foreign-based swap with a foreign counterparty that is also an Other Non-U.S. Person.[325] In these circumstances, where no party to the foreign-based swap is a U.S. person, guaranteed by a U.S. person, or an SRS, and, the particular swap is a foreign-based swap, notwithstanding that one or both parties to such swap may be a swap entity, the Commission believes that foreign regulators may have a relatively stronger supervisory interest in regulating such swaps with respect to the subject matter covered by the group B requirements, and that, in the interest of international comity, applying the group B requirements to these foreign-based swaps is not warranted.[326]

4. Foreign Branch Group B Exception

The Commission is also proposing that each foreign branch of a U.S. swap entity would be excepted from the group B requirements, with respect to any foreign-based swap with a foreign counterparty that is an Other Non-U.S. Person, subject to certain

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[324] *See supra* section I.C.2.
[325] Proposed § 23.23(e)(2). This approach is similar to the Guidance; however, the Commission notes that the Proposed Rule limits the non-U.S. swap entities eligible for this exception to those that are Other Non-U.S. Persons, and the Guidance did not contain a similar limitation. See Guidance, 78 FR at 45352-53.
[326] The Commission notes that, generally, it would expect swap entities that rely on this exception to be subject to risk mitigation standards in the foreign jurisdictions in which they reside similar to those included in the Group B Requirements, as most jurisdictions surveyed by the FSB in respect of their swaps trading have implemented such standards. *See* 2019 FSB Progress Report, Table M.

limitations.[327] Specifically, (1) the exception would not be available with respect to any group B requirement for which substituted compliance (discussed in section VI.C below) is available for the relevant swap; and (2) in any calendar quarter, the aggregate gross notional amount of swaps conducted by a swap entity in reliance on the exception may not exceed five percent of the aggregate gross notional amount of all its swaps in that calendar quarter.[328]

The Commission is proposing the Foreign Branch Group B Exception to allow the foreign branches of U.S. swap entities to continue to access swap markets for which substituted compliance may not be available under limited circumstances.[329] The Commission believes the Foreign Branch Group B Exception is appropriate because U.S. swap entities' activities through foreign branches in these markets, though not significant in volume in many cases, may nevertheless be an integral element of a U.S. swap entity's global business. Additionally, although not the Commission's main purpose, the Commission endeavors to preserve liquidity in the emerging markets in which it expects this exception to be utilized, which may further encourage the global use and development of swap markets. Further, because of the proposed five percent cap on the use of the exception, the Commission preliminarily believes that the swap activity that would be excepted from the group B requirements would not raise significant supervisory concerns.

[327] Proposed § 23.23(e)(3). This is similar to a limited exception for transactions by foreign branches in certain specified jurisdictions in the Guidance. *See* Guidance, 78 FR at 45351.

[328] Proposed § 23.23(e)(3)(i) and (ii). For example, if a swap entity were to enter into $10 billion in aggregate gross notional of swaps in a calendar quarter, no more than $500 million in aggregate gross notional of such swaps would be eligible for the Foreign Branch Group B Exception.

[329] As noted above, where substituted compliance is available for a particular group B requirement and swap, the proposed exception would not be available. Proposed § 23.23(e)(3)(i).

5. Request for Comment

The Commission invites comment on all aspects of the Proposed Rule, including each of the proposed exceptions discussed above, and specifically requests comments on the following questions. Please explain your responses and provide alternatives to the relevant portions of the Proposed Rule, where applicable.

(29) In light of the Commission's supervisory interests, are the proposed exceptions appropriate? Should they be broadened or narrowed? For example, should the Exchange-Traded Exception be available to swaps other than foreign-based swaps? Should U.S. swap entities (other than their foreign branches) be eligible for any of the exceptions and under what circumstances? Should there be further limitations on the types of exchanges on which swaps eligible for the Exchange-Traded Exception may occur? With respect to foreign-based swaps with foreign branches, should the Foreign Swap Group C Exception be limited to swaps with foreign branches of a swap entity? Should the Non-U.S. Swap Entity Group B Exception and/or Foreign Branch Group B Exception be expanded to apply to foreign-based swaps with foreign counterparties that are foreign branches and/or to SRSs that are commercial entities? Should the Commission increase, decrease, or otherwise change the cap under the Foreign Branch Group B Exception?

(30) With respect to the Non-U.S. Swap Entity Group B Exception, the Commission considered as an alternative allowing for substituted compliance for swaps that would be eligible for the exception. Would allowing for substituted compliance in

these circumstances be a better approach than providing the Non-U.S. Swap Entity Group B Exception?

C. Substituted Compliance

Substituted compliance is a fundamental component of the Commission's cross-border framework.[330] It is intended to promote the benefits of integrated global markets by reducing the degree to which market participants will be subject to duplicative regulations. Substituted compliance also fosters international harmonization by encouraging U.S. and foreign regulators to seek to adopt consistent and comparable regulatory regimes that can result in deference to each other's regime.[331] When properly calibrated, substituted compliance promotes open, transparent, and competitive markets without compromising market integrity. On the other hand, when construed too broadly, substituted compliance could defer important regulatory interests to foreign regulators that have not implemented comparably robust regulatory frameworks.

The Commission believes that in order to achieve the important policy goals of the Dodd-Frank Act, all U.S. swap entities must be fully subject to the Dodd-Frank Act requirements addressed by the Proposed Rule, without regard to whether their counterparty is a U.S. or non-U.S. person.[332] Given that such firms conduct their

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[330] For example, in addition to the Guidance, the Commission has provided substituted compliance with respect to foreign futures and options transactions (*see, e.g.*, Foreign Futures and Options Transactions, 67 FR 30785 (May 8, 2002); Foreign Futures and Options Transactions, 71 FR 6759 (Feb. 9, 2006)) and margin for uncleared swaps (*see* Cross-Border Margin Rule, 81 FR 34818).

[331] Substituted compliance, therefore, also is consistent with the directive of Congress in the Dodd-Frank Act that the Commission "coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation" of swaps and swap entities. *See* Dodd-Frank Act, Pub. L. 111-203 section 752(a); 15 U.S.C. 8325.

[332] As further explained below, the Commission is proposing limited substituted compliance for swaps conducted through a foreign branch with foreign counterparties.

business within the United States, their activities inherently have a direct and significant connection with activities in, or effect on, U.S. commerce. However, the Commission recognizes that, in certain circumstances, non-U.S. swap entities' activities with non-U.S. persons may have a more attenuated nexus to U.S. commerce. Further, the Commission acknowledges that foreign jurisdictions also have a supervisory interest in such activity. The Commission therefore believes that substituted compliance may be appropriate for non-U.S. swap entities and foreign branches of U.S. swap entities in certain circumstances.

In light of the interconnectedness of the global swap market and consistent with CEA section 2(i) and international comity, the Commission is proposing a substituted compliance regime with respect to the group A and group B requirements that builds upon the Commission's current substituted compliance framework and aims to promote diverse markets without compromising the central tenets of the Dodd-Frank Act. As discussed below, the Proposed Rule outlines the circumstances in which a non-U.S. swap entity or foreign branch of a U.S. swap entity would be permitted to comply with the group A and/or group B requirements by complying with comparable standards in its home jurisdiction.

1. Proposed Substituted Compliance Framework for the Group A Requirements

The group A requirements, which relate to compliance programs, risk management, and swap data recordkeeping, are generally implemented on a firm-wide basis in order to effectively address enterprise risk. Accordingly, it is not practical to limit substituted compliance for the group A requirements to only those transactions involving non-U.S. persons. Further, the Commission recognizes that foreign regulators maintain the primary relationships with, and may have the strongest supervisory interests over, non-U.S. swap entities. Therefore, given that the group A requirements cannot be effectively applied on a fragmented jurisdictional basis, and in furtherance of international comity, the Commission is proposing to permit a non-U.S. swap entity to avail itself of substituted compliance with respect to the group A requirements where the non-U.S swap entity is subject to comparable regulation in its home jurisdiction.[333]

2. Proposed Substituted Compliance Framework for the Group B Requirements

Unlike the group A requirements, the group B requirements, which relate to counterparty relationship documentation, portfolio reconciliation and compression, trade confirmation, and daily trading records, are more closely tied to local market conventions and can be effectively implemented on a transaction-by-transaction or relationship basis. It is therefore practicable to allow substituted compliance for group B requirements for transactions with non-U.S. persons. The Commission also recognizes that foreign regulators may have strong supervisory interests in transactions that take place in their jurisdiction. Accordingly, the Commission is proposing to permit a non-U.S. swap entity or foreign branch of a U.S. swap entity to avail itself of substituted compliance for the group B requirements in certain circumstances, depending on the nature of its counterparty.

[333] Proposed § 23.23(f)(1). This approach is consistent with the Guidance. *See* Guidance, 78 FR at 45338.

As discussed above, the Commission believes that swaps involving U.S. persons are one of the types of swaps that have a direct and significant connection with activities in, or effect on, U.S. commerce. Accordingly, the Proposed Rule would generally not permit substituted compliance for the group B requirements for swaps where one of the counterparties is a U.S. person.[334] However, the Commission recognizes that substituted compliance may be appropriate in certain circumstances for foreign branches of U.S. swap entities. Although foreign branches are fully integrated within U.S. persons, they generally enter into foreign-based swaps. In such cases, the Commission believes it may not be appropriate to impose strict adherence to the Commission's group B requirements, which are tailored to U.S. market practices. The Commission acknowledges that requiring foreign branches of U.S. swap entities to comply with U.S.-based requirements in non-U.S. markets may place them at a competitive disadvantage.

Given that group B requirements can be effectively applied on a transaction-by-transaction basis, and the Commission's interest in promoting international comity and market liquidity, the Commission is proposing to allow a non-U.S. swap entity (unless transacting though a U.S. branch), or a U.S. swap entity transacting through a foreign branch, to avail itself of substituted compliance with respect to the group B requirements for swaps with foreign counterparties.[335]

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[334] As further explained below, the Commission is proposing a limited exception for swaps conducted through a foreign branch with foreign counterparties.

[335] Proposed § 23.23(f)(2). This approach is consistent with the Guidance. The Commission is proposing to limit the availability of substituted compliance to swaps conducted through a foreign branch of a U.S. swap entity as an anti-evasion measure to prevent U.S. swap entities from simply booking trades in a foreign branch to avoid the group B requirements.

3. Request for Comment

The Commission invites comment on all aspects of the Proposed Rule, including its proposed approach to substituted compliance for the group A and group B requirements, and specifically requests comments on the following questions. Please explain your responses and provide alternatives to the relevant portions of the Proposed Rule, where applicable.

(31) Should the Commission continue to treat group A requirements differently than group B requirements for purposes of substituted compliance? Should the Commission adopt a universal entity-wide or transaction-by-transaction approach?

(32) Should the Commission expand or narrow the availability of substituted compliance for swaps involving U.S. persons?

(33) Is it practicable for non-U.S. swap entities to utilize substituted compliance for transactions with non-U.S. persons?[336]

(34) Given that the Guidance did not apply the group B requirements to swaps between certain non-U.S. persons, should the Commission consider a phase-in period for the application of the group B requirements for swaps between SDs that are Guaranteed Entities or SRSs with counterparties that are Other Non-U.S. Persons where substituted compliance is not currently available?

(35) To what extent do foreign branches of U.S. swap entities enter into swaps with U.S. persons or affiliates of U.S. persons?

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[336] The Commission notes that while the Guidance stated that all swap entities (wherever located) are subject to all of the CFTC's Title VII requirements, the Guidance went on to describe how and when the Commission would expect swap entities to comply with specific ELRs and TLRs, and when substituted compliance would be available.

(36) Should the Commission treat foreign branches differently than the rest of the U.S. swap entity for purposes of substituted compliance?

(37) How did/does the approach to substituted compliance in the Guidance positively and negatively impact market practices? Please provide any data in support of your comment.

D. Comparability Determinations

The Commission is proposing to implement a process pursuant to which it would, in connection with certain requirements addressed by the Proposed Rule, conduct comparability determinations regarding a foreign jurisdiction's regulation of swap entities. The proposed approach builds upon the Commission's existing substituted compliance regime and aims to promote international comity and market liquidity without compromising the Commission's interests in reducing systemic risk, increasing market transparency, enhancing market integrity, and promoting counterparty protections. Specifically, the Proposed Rule outlines procedures for initiating comparability determinations, including eligibility and submission requirements, with respect to certain requirements addressed by the Proposed Rule. The Proposed Rule would establish a standard of review that the Commission would apply to such comparability determinations that emphasizes a holistic, outcomes-based approach. The Proposed Rule, if adopted, is not intended to have any impact on the effectiveness of any existing Commission comparability determinations that were issued consistent with the Guidance, which would remain effective pursuant to their terms.[337]

As discussed above, the Commission is proposing to permit a non-U.S. swap entity or foreign branch of a U.S. swap entity to comply with a foreign jurisdiction's swap standards in lieu of the Commission's corresponding requirements in certain cases, provided that the Commission determines that such foreign standards are comparable to the Commission's requirements. All swap entities, regardless of whether they rely on such a comparability determination, would remain subject to the Commission's examination and enforcement authority.[338] Accordingly, if a swap entity fails to comply with a foreign jurisdiction's relevant standards, or the terms of the applicable comparability determination, the Commission could initiate an action for a violation of the Commission's corresponding requirements.

1. Standard of Review

The Commission is proposing to establish a standard of review pursuant to which the Commission would determine whether a foreign jurisdiction's regulatory standards are comparable to the group A and group B requirements. The Commission is proposing a flexible outcomes-based approach that emphasizes comparable regulatory outcomes

[337] *See, e.g.,* Comparability Determination for Australia: Certain Entity-Level Requirements, 78 FR 78864 (Dec. 27, 2013); Comparability Determination for Canada: Certain Entity-Level Requirements, 78 FR 78839 (Dec. 27, 2013); Comparability Determination for the European Union: Certain Entity-Level Requirements, 78 FR 78923 (Dec. 27, 2013); Comparability Determination for Hong Kong: Certain Entity-Level Requirements, 78 FR 78852 (Dec. 27, 2013); Comparability Determination for Japan: Certain Entity-Level Requirements, 78 FR 78910 (Dec. 27, 2013); Comparability Determination for Switzerland: Certain Entity-Level Requirements, 78 FR 78899 (Dec. 27, 2013); Comparability Determination for the European Union: Certain Transaction-Level Requirements, 78 FR 78878 (Dec. 27, 2013); and Comparability Determination for Japan: Certain Transaction-Level Requirements, 78 FR 78890 (Dec. 27, 2013).

[338] Proposed § 23.23(g)(5). The Commission notes that the National Futures Association ("NFA") has certain delegated authority with respect to SDs and MSPs. Additionally, all registered SDs and MSPs are required to be members of the NFA and are subject to examination by the NFA.

over identical regulatory approaches.[339] The Commission has published numerous comparability determinations consistent with the Guidance and pursuant to the Cross-Border Margin Rule.[340] In doing so, the Commission has developed a deeper understanding of the nuances in comparing foreign jurisdictions' regulatory approaches with that of the Commission. Specifically, the Commission has identified several circumstances in which a foreign jurisdiction may achieve comparable regulatory outcomes to those of the CFTC, notwithstanding certain differences in regulatory or supervisory structures. For example, in certain jurisdictions, the Commission has found comparability with respect to certain Commission requirements based on a combination of robust prudential supervision coupled with supervisory guidelines to achieve comparable regulatory outcomes as the Commission requirements.[341] Therefore, the Commission believes it is necessary to adopt a flexible approach to substituted compliance that would enable it to address a broad range of regulatory approaches.

While the Commission has historically taken a similar outcomes-based approach to comparability determinations, the Proposed Rule would allow the Commission to take an even more holistic view of a foreign jurisdiction's regulatory regime. Specifically, the Proposed Rule would allow the Commission to consider all relevant elements of a foreign jurisdiction's regulatory regime, thereby allowing the Commission to tailor its assessment

[339] This is similar to the Commission's approach in the Guidance (*see* Guidance, 78 FR at 45342-43) and the Cross-Border Margin Rule *(see* Cross-Border Margin Rule, 81 FR at 34846).
[340] *See e.g., supra* notes 142 and 337.
[341] *See*, *e.g.*, Comparability Determination for Canada: Certain Entity-Level Requirements, 78 FR 78839 (Dec. 27, 2013); Amendment to Comparability Determination for Japan: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 84 FR 12074 (Apr. 1, 2019).

to a broad range of foreign regulatory approaches.[342] Accordingly, pursuant to the Proposed Rule, a foreign jurisdiction's regulatory regime would not need to be identical to the relevant Commission requirements, so long as both regulatory frameworks are comparable in terms of holistic outcome. Under the Proposed Rule, in assessing comparability, the Commission may consider any factor it deems appropriate, which may include: (1) the scope and objectives of the relevant foreign jurisdiction's regulatory standards; (2) whether, despite differences, a foreign jurisdiction's regulatory standards achieve comparable regulatory outcomes to the Commission's corresponding requirements; (3) the ability of the relevant regulatory authority or authorities to supervise and enforce compliance with the relevant foreign jurisdiction's regulatory standards; and (4) whether the relevant foreign jurisdiction's regulatory authorities have entered into a memorandum of understanding or similar cooperative arrangement with the Commission regarding the oversight of swap entities.[343] The Proposed Rule would also enable the Commission to consider other relevant factors, including whether a foreign regulatory authority has issued a reciprocal comparability determination with respect to the Commission's corresponding regulatory requirements. Further, given that some foreign jurisdictions may implement prudential supervisory guidelines in the regulation of swaps, the Proposed Rule would allow the Commission to base

[342] Under the Proposed Rule, the Commission would consider all relevant elements of a foreign jurisdiction's regulatory regime; however, the fact that a foreign regulatory regime may not address one of more of such elements would not preclude a finding of comparability by the Commission. Also, in making a comparability determination, the Commission would have the flexibility to weigh more heavily elements it deems to be more critical than others and less heavily those that it deems to be less critical.

[343] Proposed § 23.23(g)(4).

comparability on a foreign jurisdiction's regulatory standards, rather than regulatory requirements.

Although, when assessed against the relevant Commission requirements, the Commission may find comparability with respect to some, but not all, of a foreign jurisdiction's regulatory standards, it may also make a holistic finding of comparability that considers the broader context of a foreign jurisdiction's related regulatory standards. Accordingly, under the Proposed Rule, a comparability determination need not contain a standalone assessment of comparability for each relevant regulatory requirement, so long as it clearly indicates the scope of regulatory requirements that are covered by the determination. Further, the Commission may impose any terms and conditions on a comparability determination that it deems appropriate.[344]

2. Eligibility Requirements

Under the Proposed Rule, the Commission could undertake a comparability determination on its own initiative in furtherance of international comity.[345] In such cases, the Commission expects that it would nonetheless engage with the relevant foreign regulator and/or regulated entities to develop a fulsome understanding of the relevant foreign regulatory regime. Alternatively, certain outside parties would also be eligible to request a comparability determination from the Commission with respect to some or all of the group A and group B requirements. Under the Proposed Rule, a comparability determination could be requested by: (1) swap entities that are eligible for substituted compliance; (2) trade associations whose members are such swap entities; or (3) foreign

[344] Proposed § 23.23(g)(6).
[345] Proposed § 23.23(g)(1).

regulatory authorities that have direct supervisory authority over such swap entities and are responsible for administering the relevant swap standards in the foreign jurisdiction.[346]

3. Submission Requirements

In connection with a comparability determination with respect to some or all of the group A and group B requirements, applicants would be required to furnish certain information to the Commission that provides a comprehensive understanding of the foreign jurisdiction's relevant swap standards, including how they might differ from the corresponding requirements in the CEA and Commission regulations.[347] Further, applicants would be expected to provide an explanation as to how any such differences may nonetheless achieve comparable outcomes to the Commission's attendant regulatory requirements.[348]

4. Request for Comment

The Commission invites comment on all aspects of the Proposed Rule, including its proposed approach to comparability determinations, and specifically requests comments on the following questions. Please explain your responses and provide alternatives to the relevant portions of the Proposed Rule, where applicable.

(38) Please provide comments regarding the Commission's proposal regarding its standard of review for comparability determinations. Should the Commission limit the factors it may consider when issuing a comparability determination?

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[346] Proposed § 23.23(g)(2).

[347] Proposed § 23.23(g)(3).

[348] Proposed § 23.23(g)(3)(iii).

(39) Should comparability determinations contain an element-by-element assessment of comparability?

(40) How should the Commission address inconsistencies or conflicts between U.S. and non-U.S. regulatory standards?

(41) How have the Commission's approaches to comparability determinations in the Guidance and the Cross-Border Margin rule positively and negatively impacted market practices? Please provide any data in support of your comment.

VII. Recordkeeping

Under the Proposed Rule, a SD or MSP would be required to create a record of its compliance with all provisions of the Proposed Rule, and retain those records in accordance with § 23.203.[349] Registrants' records are a fundamental element of an entity's compliance program, as well as the Commission's oversight function. Accordingly, such records should be sufficiently detailed to allow compliance officers and regulators to assess compliance with the Proposed Rule.

VIII. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA") requires that agencies consider whether the regulations they propose will have a significant economic impact on a substantial number of small entities.[350] The Commission previously established definitions of "small entities" to be used in evaluating the impact of its regulations on small entities in

[349] Proposed § 23.23(h).
[350] *See* 5 U.S.C. 601 *et seq*.

accordance with the RFA.[351] The Proposed Rule addresses when U.S. persons and non-U.S. persons would be required to include their cross-border swap dealing transactions or swap positions in their SD or MSP registration threshold calculations, respectively,[352] and the extent to which SDs or MSPs would be required to comply with certain of the Commission's regulations in connection with their cross-border swap transactions or swap positions.[353]

The Commission previously determined that SDs and MSPs are not small entities for purposes of the RFA.[354] The Commission believes, based on its information about the swap market and its market participants, that: (1) the types of entities that may engage in more than a de minimis amount of swap dealing activity such that they would be required to register as an SD – which generally would be large financial institutions or other large entities – would not be "small entities" for purposes of the RFA, and (2) the types of entities that may have swap positions such that they would be required to register as an MSP would not be "small entities" for purposes of the RFA. Thus, to the extent such entities are large financial institutions or other large entities that would be required to

[351] *See* 47 FR 18618 (Apr. 30, 1982) (finding that DCMs, FCMs, commodity pool operators and large traders are not small entities for RFA purposes).
[352] Proposed § 23.23(b)-(d).
[353] Proposed § 23.23(e).
[354] *See* Entities Rule, 77 FR at 30701; Registration of Swap Dealers and Major Swap Participants, 77 FR 2613, 2620 (Jan. 19, 2012) (noting that like FCMs, SDs will be subject to minimum capital requirements, and are expected to be comprised of large firms, and that MSPs should not be considered to be small entities for essentially the same reasons that it previously had determined large traders not to be small entities).

register as SDs or MSPs with the Commission by virtue of their cross-border swap dealing transactions and swap positions, they would not be considered small entities.[355]

To the extent that there are any affected small entities under the Proposed Rule, they would need to assess how they are classified under the Proposed Rule (*i.e.*, U.S. person, SRS, Guaranteed Entity, and Other Non-U.S. Person) and monitor their swap activities in order to determine whether they are required to register as an SD under the Proposed Rule. The Commission believes that, if the Proposed Rule is adopted, market participants would only incur incremental costs, which are expected to be small, in modifying their existing systems and policies and procedures resulting from changes to the status quo made by the Proposed Rule.[356]

Accordingly, for the foregoing reasons, the Commission finds that there will not be a substantial number of small entities impacted by the Proposed Rule. Therefore, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the proposed regulations will not have a significant economic impact on a substantial number of small entities. The Commission invites comment on the impact of the Proposed Rule on small entities.

[355] The SBA's Small Business Size Regulations, codified at 13 CFR 121.201, identifies (through North American Industry Classification System codes) a small business size standard of $38.5 million or less in annual receipts for Sector 52, Subsector 523—Securities, Commodity Contracts, and Other Financial Investments and Related Activities. Entities that would be affected by the Proposed Rule are generally large financial institutions or other large entities that would be required to include their cross-border dealing transactions or swap positions toward the SD and MSP registration thresholds, respectively, as specified in the Proposed Rule.

[356] The Proposed Rule addresses the cross-border application of the registration and certain other regulations. The Proposed Rule would not change such regulations.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (“PRA”)[357] imposes certain requirements on Federal agencies, including the Commission, in connection with their conducting or sponsoring any collection of information, as defined by the PRA. The Proposed Rule provides for the cross-border application of the SD and MSP registration thresholds and the group A, group B, and group C requirements.

Proposed §§ 23.23(b) and (c), which address the cross-border application of the SD and MSP registration thresholds, respectively, potentially could lead to non-U.S. persons that are currently not registered as SDs or MSPs to exceed the relevant registration thresholds, therefore requiring the non-U.S. persons to register as SDs or MSPs. However, the Commission preliminarily believes that, if adopted, the Proposed Rule will not result in any new registered SDs or MSPs or the deregistration of registered SDs,[358] and therefore, it does not believe an amendment to any existing collection of information is necessary as a result of proposed §§ 23.23(b) and (c). Specifically, the Commission does not believe the Proposed Rule, if adopted, would change the number of respondents under the existing collection of information, “Registration of Swap Dealers and Major Swap Participants,” Office of Management and Budget (“OMB”) Control No. 3038–0072.

Similarly, proposed § 23.23(h) contains collection of information requirements within the meaning of the PRA as it would require that swap entities create a record of their compliance with § 23.23 and retain records in accordance with § 23.203; however,

[357] 44 U.S.C. 3501 *et seq*.
[358] There are not currently any registered MSPs.

the Commission believes that records suitable to demonstrate compliance are already required to be created and maintained under the collections related to the Commission's swap entity registration, group B, and group C requirements. Specifically, existing collections of information, "Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants," OMB Control No. 3038-0068; "Registration of Swap Dealers and Major Swap Participants," OMB Control No. 3038–0072; "Swap Dealer and Major Swap Participant Conflicts of Interest and Business Conduct Standards with Counterparties," OMB Control No. 3038-0079; "Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants," OMB Control No. 3038-0083; "Reporting, Recordkeeping, and Daily Trading Records Requirements for Swap Dealers and Major Participants," OMB Control No. 3038-0087; and "Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants," OMB Control No. 3038-0088 relate to these requirements.[359] Accordingly, the Commission is not submitting to OMB an information collection request to create a new information collection in relation to proposed § 23.23(h).

Proposed § 23.23(g) would result in collection of information requirements within the meaning of the PRA, as discussed below. The Proposed Rule contains collections of

[359] To the extent a swap entity avails itself of an exception from a group B or group C requirement under the Proposed Rule and, thus, is no longer required to comply with the relevant group B and/or group C requirements and related paperwork burdens, the Commission expects the paperwork burden related to that exception would be less than that of the corresponding requirement(s). However, in an effort to be conservative, because the Commission does not know how many swap entities will choose to avail themselves of the exceptions and for how many foreign-based swaps, the Commission is not changing the burden of its related collections to reflect the availability of such exceptions.

information for which the Commission has not previously received control numbers from the Office of Management and Budget ("OMB"). If adopted, responses to this collection of information would be required to obtain or retain benefits. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The Commission has submitted to OMB an information collection request to create a new information collection under OMB control number 3038-0072 (Registration of Swap Dealers and Major Swap Participants) for the collections contained in the Proposed Rule.

As discussed in section VI.C above, the Commission is proposing to permit a non-U.S. swap entity or foreign branch of a U.S. swap entity to comply with a foreign jurisdiction's swap standards in lieu of the Commission's corresponding group A and group B requirements in certain cases, provided that the Commission determines that such foreign standards are comparable to the Commission's requirements. Proposed § 23.23(g) would implement a process pursuant to which the Commission would conduct these comparability determinations, including outlining procedures for initiating such determinations. As discussed in section VI.D above, a comparability determination could be requested by swap entities that are eligible for substituted compliance, their trade associations, and foreign regulatory authorities meeting certain requirements.[360] Applicants seeking a comparability determination would be required to furnish certain information to the Commission that provides a comprehensive explanation of the foreign jurisdiction's relevant swap standards, including how they might differ from the

[360] Proposed § 23.23(g)(2).

corresponding requirements in the CEA and Commission regulations and how, notwithstanding such differences, the foreign jurisdiction's swap standards achieve comparable outcomes to those of the Commission.[361] The information collection would be necessary for the Commission to consider whether the foreign jurisdiction's relevant swap standards are comparable to the Commission's requirements.

Though under the Proposed Rule many entities would be eligible to request a comparability determination,[362] the Commission expects to receive far fewer requests because once a comparability determination is made for a jurisdiction it would apply for all entities or transactions in that jurisdiction to the extent provided in the Commission's determination. Further, the Commission has already issued comparability determinations under the Guidance for certain of the Commission's requirements for Australia, Canada, the European Union, Hong Kong, Japan, and Switzerland,[363] and the effectiveness of those determinations would not be affected by the Proposed Rule. Nevertheless, in an effort to be conservative in its estimate for purposes of the PRA, the Commission estimates that, if the Proposed Rule is adopted, it will receive a request for a comparability determination in relation to five (5) jurisdictions per year. Further, based on the Commission's experience in issuing comparability determinations, the Commission estimates that each request would impose an average of 40 burden hours, for an aggregate estimated hour burden of 200 hours. Accordingly, the proposed changes

[361] Proposed § 23.23(g)(3).
[362] Currently, there are approximately 107 swap entities provisionally registered with the Commission, many of which may be eligible to apply for a comparability determination as a non-U.S. swap entity or a foreign branch. Additionally, a trade association, whose members include swap entities, and certain foreign regulators may also apply for a comparability determination.
[363] *See supra* note 142 and 337.

would result in an increase to the current burden estimates of OMB control number 3038-0072 by 5 in the number of submissions and 200 burden hours.

The frequency of responses and total new burden associated with OMB control number 3038-0072, in the aggregate, reflecting the new burden associated with all the amendments proposed by the rulemaking and current burden not affected by this rulemaking,[364] is as follows:

Estimated annual number of respondents: 770

Estimated aggregate annual burden hours per respondent: 1.13 hours

Estimated aggregate annual burden hours for all respondents: 872

Frequency of responses: As needed.

Information Collection Comments. The Commission invites the public and other Federal agencies to comment on any aspect of the proposed information collection requirements discussed above, including, without limitation, the Commission's discussion of the estimated burden of the collection of information requirements in § 23.23(h). Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (1) evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (2) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information; (3) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (4) minimize the burden of the collection of information on those who are

[364] The numbers below reflect the current burden for two separate information collections that are not affected by this rulemaking.

to respond, including through the use of automated collection techniques or other forms of information technology.

Comments may be submitted directly to the Office of Information and Regulatory Affairs, by fax at (202) 395-6566, or by e-mail at *OIRAsubmissions@omb.eop.gov*. Please provide the Commission with a copy of submitted comments so that all comments can be summarized and addressed in the final rule preamble. Refer to the **ADDRESSES** section of this notice for comment submission instructions to the Commission. A copy of the supporting statements for the collection of information discussed above may be obtained by visiting RegInfo.gov. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this document in the *Federal Register*. Therefore, a comment is best assured of having its full effect if OMB receives it within 30 days of publication.

C. Cost-Benefit Considerations

As detailed above, the Commission is proposing rules that would define certain key terms for purposes of certain Dodd-Frank Act swap provisions and address the cross-border application of the SD and MSP registration thresholds and the Commission's group A, group B, and group C requirements.

The baseline against which the costs and benefits of the Proposed Rule are considered is, in principle, current law: in other words, applicable Dodd-Frank Act swap provisions in the CEA and regulations promulgated by the Commission to date, as made applicable to cross-border transactions by Congress in CEA section 2(i), in the absence of a Commission rule establishing more precisely the application of that provision in particular situations. However, in practice, use of this baseline poses important challenges, for a number of reasons.

First, there are intrinsic difficulties in sorting out costs and benefits of the Proposed Rule from costs and benefits intrinsic to the application of Dodd-Frank Act requirements to cross-border transactions directly pursuant to section 2(i), given that statute sets forth general principles for the cross-border application of Dodd-Frank Act swap requirements but does not attempt to address particular business situations in detail.

Second, the Guidance established a general, non-binding framework for the cross-border application of many substantive Dodd-Frank Act requirements. In doing so, the Guidance considered, among other factors, the regulatory objectives of the Dodd-Frank Act and principles of international comity. As is apparent from the text of the Proposed Rule and the discussion in this preamble, the Proposed Rule is in certain respects consistent with the Guidance. The Commission understands that, while the Guidance is non-binding, many market participants have developed policies and practices that take into account the views expressed therein. At the same time, some market participants may currently apply CEA section 2(i), the regulatory objectives of the Dodd-Frank Act, and principles of international comity in ways that vary from the Guidance, for example because of circumstances not contemplated by the general, non-binding framework in the Guidance.

Third, in addition to the Guidance, the Commission has issued comparability determinations finding that certain provisions of the laws and regulations of other jurisdictions are comparable in outcome to certain requirements under the CEA and regulations thereunder.[365] In general, under these determinations, a market participant that complies with the specified provisions of the other jurisdiction would also be deemed to be in compliance with Commission regulations, subject to certain conditions.[366]

Fourth, the Commission staff has issued several interpretive and no-action letters that are relevant to cross-border issues.[367] As with the Guidance, the Commission recognizes that many market participants have relied on these staff letters in framing their business practices.

Fifth, as noted above, the international regulatory landscape is far different now than it was when the Dodd-Frank Act was enacted in 2010.[368] Even in 2013, when the CFTC published the Guidance, very few jurisdictions had made significant progress in implementing the global swap reforms that were agreed to by the G20 leaders at the Pittsburgh G20 Summit. Today, however, as a result of cumulative implementation efforts by regulators throughout the world, significant and substantial progress has been made in the world's primary swap trading jurisdictions to implement the G20 commitments. For these reasons, the actual costs and benefits of the Proposed Rule that would be experienced by a particular market participant may vary depending on the jurisdictions in which the market participant is active and when the market participant took steps to comply with various legal requirements.

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[365] *See supra* notes 142 and 337.
[366] *See id*.
[367] *See, e.g.,* CFTC Letter No. 13-64, No-Action Relief: Certain Swaps by Non-U.S. Persons that are Not Guaranteed or Conduit Affiliates of a U.S. Person Not to be Considered in Calculating Aggregate Gross Notional Amount for Purposes of Swap Dealer De Minimis Exception (Oct. 17, 2013), available at https://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/13-64.pdf; ANE Staff Advisory; ANE No-Action Relief; and CFTC Staff Letter No. 18-13.
[368] *See supra* section I.B.

Because of these complicating factors, as well as limitations on available information, the Commission believes that a direct comparison of the costs and benefits of the Proposed Rule with those of a hypothetical cross-border regime based directly on section 2(i) – while theoretically the ideal approach – is infeasible in practice. As a further complication, the Commission recognizes that the Proposed Rule's costs and benefits would exist, regardless of whether a market participant: (1) first realized some of those costs and benefits when it conformed its business practices to provisions of the Guidance or Commission staff action that would now become binding legal requirements under the Proposed Rule; (2) does so now for the first time; or (3) did so in stages as international requirements evolved.

In light of these considerations, the Commission will consider costs and benefits by focusing primarily on two types of information and analysis.

First, the Commission will compare the Proposed Rule with current business practice, on the understanding that many market participants are now conducting business taking into account the Guidance, applicable CFTC staff letters, and existing comparability determinations. This approach will, for example, compare expected costs and benefits of conducting business under the Proposed Rule with those of conducting business in conformance with analogous provisions of the Guidance. In effect, this inquiry will examine *new* costs and benefits that would result from the Proposed Rule for market participants that are currently following the relevant Dodd-Frank Act swap provisions and regulations thereunder, the Guidance, the comparability determinations, and applicable staff letters. This is referred to as "Baseline A."

Second, to the extent feasible, the Commission will consider relevant information on costs and benefits that industry has incurred *to date* in complying with the Dodd-Frank Act in cross-border transactions of the type that would be affected by the Proposed Rule. In light of the overlap in the subjects addressed by the Guidance and the Proposed Rule, this will include consideration of costs and benefits that have been generated where market participants have chosen to conform their business practices to the Guidance in areas relevant to the Proposed Rule. This second form of inquiry is, to some extent, over inclusive in that it is likely to capture some costs and benefits that flow directly from Congress's enactment of section 2(i) of the CEA or that otherwise are not strictly attributable to the Proposed Rule. However, since a theoretically perfect baseline for consideration of costs and benefits does not appear feasible, this second form of inquiry will help ensure that costs and benefits of the Proposed Rules are considered as fully as possible. This is referred to as "Baseline B."

The Commission invites comments regarding all aspects of the baselines applied in this consideration of costs and benefits. In particular, the Commission would like commenters to address any variances or different circumstances they have experienced that affect the baseline for those commenters. Please be as specific as possible and include quantitative information where available.

The costs associated with the key elements of the Commission's proposed cross-border approach to the SD and MSP registration thresholds – requiring market participants to classify themselves as U.S. persons, Guaranteed Entities, or SRSs[369] and to

[369] Proposed § 23.23(a).

apply the rules accordingly – fall into a few categories. Market participants would incur costs determining which category of market participant they and their counterparties fall into ("assessment costs"), tracking their swap activities or positions to determine whether they should be included in their registration threshold calculations ("monitoring costs"), and, to the degree that their activities or positions exceed the relevant threshold, registering with the Commission as an SD or MSP ("registration costs").

Entities required to register as SDs or MSPs as a result of the Proposed Rule would also incur costs associated with complying with the relevant Dodd-Frank Act requirements applicable to registrants, such as the capital (when promulgated), margin, and business conduct requirements ("programmatic costs").[370] While only new registrants would be assuming these programmatic costs for the first time, the obligations of entities that are already registered as SDs may also change in the future as an indirect consequence of the Proposed Rule.

In developing the Proposed Rule, the Commission took into account the potential for creating or accentuating competitive disparities between market participants, which could contribute to market deficiencies, including market fragmentation or decreased liquidity, as more fully discussed below. Notably, competitive disparities may arise between U.S.-based financial groups and non-U.S. based financial groups as a result of differences in how the SD and MSP registration thresholds apply to the various classifications of market participants. For instance, an SRS must count all dealing swaps

[370] The Commission's discussion of programmatic costs and registration costs does not address MSPs. No entities are currently registered as MSPs, and the Commission does not expect that this status quo would change as a result of the Proposed Rule being adopted given the general similarities between the Proposed Rule's approach to the MSP registration threshold calculations and the Guidance.

toward its SD de minimis calculation. Therefore, SRSs would be more likely to trigger the SD registration threshold relative to Other Non-U.S. Persons, and may therefore be at a competitive disadvantage compared to Other Non-U.S. Persons when trading with non-U.S. persons, as non-U.S. persons may prefer to trade with non-registrants in order to avoid application of the Dodd-Frank Act swap regime.[371] On the other hand, the Commission notes that certain counterparties may prefer to enter into swaps with SDs and MSPs that are subject to the robust requirements of the Dodd-Frank Act.

Other factors also create inherent challenges associated with attempting to assess costs and benefits of the Proposed Rule. To avoid the prospect of being regulated as an SD or MSP, or otherwise falling within the Dodd-Frank Act swap regime, some market participants may restructure their businesses or take other steps (*e.g.*, limiting their counterparties to Other Non-U.S. Persons) to avoid exceeding the relevant registration thresholds. The degree of comparability between the approaches adopted by the Commission and foreign jurisdictions and the potential availability of substituted compliance, whereby a market participant may comply with certain Dodd-Frank Act SD or MSP requirements by complying with a comparable requirement of a foreign financial regulator, may also affect the competitive impact of the Proposed Rule. The Commission expects that such impacts would be mitigated as the Commission continues to work with foreign and domestic regulators to achieve international harmonization and cooperation.

[371] Dodd-Frank Act swap requirements may impose significant direct costs on participants falling within the SD or MSP definitions that are not borne by other market participants, including costs related to capital and margin requirements and business conduct requirements. To the extent that foreign jurisdictions adopt comparable requirements, these costs would be mitigated.

In the sections that follow, the Commission discusses the costs and benefits associated with the Proposed Rule.[372] Section 1 begins by addressing the assessment costs associated with the Proposed Rule, which derive in part from the defined terms used in the Proposed Rule (*e.g.*, the proposed definitions of "U.S. person," "significant risk subsidiary," and "guarantee"). Sections 2 and 3 consider the costs and benefits associated with the Proposed Rule's determinations regarding how each classification of market participants apply to the SD and MSP registration thresholds, respectively. Sections 4, 5, and 6 address the monitoring, registration, and programmatic costs associated with the proposed cross-border approach to the SD (and, as appropriate, MSP) registration thresholds, respectively. Section 7 addresses the costs and benefits associated with the Proposed Rule's exceptions from, and available substituted compliance for, the group A, group B, and group C requirements, as well as comparability determinations. Section 8 addresses the costs associated with the Proposed Rule's recordkeeping requirements. Section 9 discusses the factors established in section 15(a) of the CEA.

The Commission invites comment regarding the nature and extent of any costs and benefits that could result from adoption of the Proposed Rule and, to the extent they can be quantified, monetary and other estimates thereof.

[372] The Commission endeavors to assess the expected costs and benefits of proposed rules in quantitative terms where possible. Where estimation or quantification is not feasible, the Commission provides its discussion in qualitative terms. Given a general lack of relevant data, the Commission's analysis in the Proposed Rule is generally provided in qualitative terms.

1. Assessment Costs

As discussed above, in applying the proposed cross-border approach to the SD and MSP registration thresholds, market participants would be required to first classify themselves as a U.S. person, an SRS, a Guaranteed Entity, or an Other Non-U.S. Person.

With respect to Baseline A, the Commission expects that the costs to affected market participants of assessing which classification they fall into would generally be small and incremental. In most cases, the Commission believes an entity will have performed an initial determination or assessment of its status under either the Cross-Border Margin Rule (which uses substantially similar definitions of "U.S. person" and "guarantee") or the Guidance (which interprets "U.S. person" in a manner that is similar but not identical to the proposed definition of "U.S. person"). Additionally, the Proposed Rule would allow market participants to rely on representations from their counterparties with regard to their classifications.[373] However, the Commission acknowledges that swap entities would have to modify their existing operations to accommodate the new concept of an SRS. Specifically, market participants would need to determine whether they or their counterparties qualify as SRSs. Further, in order to rely on certain exclusions outlined in the Proposed Rule, swap entities would need to obtain annual representations regarding a counterparty's status as an SRS.

With respect to Baseline B, wherein only certain market participants would have previously determined their status under the similar, but not identical, Cross-Border

[373] The Commission believes that these assessment costs for the most part have already been incurred by potential SDs and MSPs as a result of adopting policies and procedures under the Guidance and Cross-Border Margin Rule (which had similar classifications), both of which permitted counterparty representations. *See* Guidance, 78 FR at 45315; Cross-Border Margin Rule, 81 FR at 34827.

Margin Rule (and not the Guidance), the Commission believes that their assessment costs would nonetheless be small as a result of the Proposed Rule's reliance on clear, objective definitions of the terms "U.S. person," "substantial risk subsidiary," and "guarantee." Further, with respect to the determination of whether a market participant falls within the "significant risk subsidiary" definition,[374] the Commission believes that assessment costs would be small as the definition relies, in part, on a familiar consolidation test already used by affected market participants in preparing their financial statements under U.S. GAAP. Further, the Commission notes that only those market participants with an ultimate U.S. parent entity that has more than $50 billion in global consolidated assets and that do not fall into one of the exceptions in proposed § 23.23(a)(12)(i) or (ii) would need to consider if they are an SRS.

Additionally, the Proposed Rule relies on the definition of "guarantee" provided in the Cross-Border Margin Rule, which is limited to arrangements in which one party to a swap has rights of recourse against a guarantor with respect to its counterparty's obligations under the swap.[375] Although non-U.S. persons would need to know whether they are Guaranteed Entities with respect to the relevant swap on a swap-by-swap basis for purposes of the SD and MSP registration calculations, the Commission believes that this information would already be known by non-U.S. persons.[376] Accordingly, with respect to both baselines, the Commission believes that the costs associated with

[374] The "substantial risk subsidiary" definition is discussed further in section II.C.
[375] *See supra* section II.B.
[376] Because a guarantee has a significant effect on pricing terms and on recourse in the event of a counterparty default, the Commission believes that the guarantee would already be in existence and that a non-U.S. person therefore would have knowledge of its existence before entering into a swap.

assessing whether an entity or its counterparty is a Guaranteed Entity would be small and incremental.

2. Cross-Border Application of the SD Registration Threshold

(i) U.S. Persons, Guaranteed Entities, and SRSs

Under the Proposed Rule, a U.S. person would include all of its swap dealing transactions in its de minimis calculation, without exception.[377] As discussed above, that would include any swap dealing transactions conducted through a U.S. person's foreign branch, as such swaps are directly attributed to, and therefore impact, the U.S. person. Given that this requirement mirrors the Guidance in this respect, the Commission believes that the Proposed Rule would have a minimal impact on the status quo with regard to the number of registered or potential U.S. SDs, as measured against Baseline A.[378] With respect to Baseline B, all U.S. persons would have included all of their transactions in its de minimis calculation, even absent the Guidance, pursuant to paragraph (4) of the SD definition.[379] However, the Commission acknowledges that, absent the Guidance, some U.S. persons may not have interpreted CEA section 2(i) to require them to include swap dealing transactions conducted through their foreign branches in their de minimis calculation. Accordingly, with respect to Baseline B, the

[377] Proposed § 23.23(b)(1).

[378] The Commission is not estimating the number of new U.S. SDs, as the methodology for including swaps in a U.S. person's SD registration calculation does not diverge from the approach included in the Guidance (*i.e.*, a U.S. person must include all of its swap dealing transactions in its de minimis threshold calculation). Further, the Commission does not expect a change in the number of SDs would result from the Proposed Rule's definition of U.S. person and therefore assumes that no additional entities would register as U.S. SDs, and no existing SD registrants would deregister as a result of the Proposed Rule, if adopted.

[379] *See* 17 CFR 1.3, Swap dealer, paragraph (4).

Commission expects that some U.S. persons may incur some incremental costs as a result of having to count swaps conducted through their foreign branches.

The Proposed Rule would also require Guaranteed Entities to include all of their dealing transactions in their de minimis threshold calculation without exception.[380] This approach, which recognizes that a Guaranteed Entity's swap dealing transactions may have the same potential to impact the U.S. financial system as a U.S. person's dealing transactions, closely parallels the approach taken in the Guidance with respect to the treatment of the swaps of "guaranteed affiliates."[381] Given that the Proposed Rule would establish a more limited definition of "guarantee" as compared to the Guidance, and a similar definition of guarantee as compared to the Cross-Border Margin Rule, the Commission does not expect that the Proposed Rule would cause more Guaranteed Entities to register with the Commission. Accordingly, the Commission believes that, in this respect, any increase in costs associated with the Proposed Rule, with respect to Baselines A and B, would be small.

Under the Proposed Rule, an SRS would include all swap dealing transactions in its de minimis threshold calculation.[382] Given that the concept of an SRS was not included in the Guidance or the Cross-Border Margin Rule, the Commission believes that

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[380] Proposed § 23.23(b)(2)(ii).

[381] While the Proposed Rule and the Guidance treat swaps involving Guaranteed Entities in a similar manner, they have different definitions of the term "guarantee." Under the Guidance, a "guaranteed affiliate" would generally include all swap dealing activities in its de minimis threshold calculation without exception. The Guidance interpreted "guarantee" to generally include "not only traditional guarantees of payment or performance of the related swaps, but also other formal arrangements that, in view of all the facts and circumstances, support the non-U.S. person's ability to pay or perform its swap obligations with respect to its swaps." *See* Guidance, 78 FR at 45320. In contrast, the term "guarantee" in the Proposed Rule has the same meaning as defined in § 23.160(a)(2) (cross-border application of the Commission's margin requirements for uncleared swaps), except that application of the proposed definition of "guarantee" would not be limited to uncleared swaps. *See supra* section 0.

[382] Proposed § 23.23(b)(1).

this aspect of the Proposed Rule would have a similar impact on market participants when measured against Baseline A and Baseline B. Under the Guidance, an SRS would likely have been categorized as either a conduit affiliate (which would have been required to count all dealing swaps towards its de minimis threshold calculation) or an Other Non-U.S. Person (which would have been required to count only a subset of its dealing swaps towards its de minimis threshold calculation). Accordingly, under the Proposed Rule, there may be some SRSs that would have to count more swaps towards their de minimis threshold calculation than would have been required under the Guidance.

However, as noted in sections II.C and III.B, the Commission believes that it would be appropriate to distinguish SRSs from Other Non-U.S. Persons in determining the cross-border application of the SD de minimis threshold to such entities. As discussed above, SRS, as a class of entities, presents a greater supervisory interest to the CFTC relative to an Other Non-U.S. Person, due to the nature and extent of the their relationships with their ultimate U.S. parent entities. Of the 60 non-U.S. SDs that were provisionally registered with the Commission as of December 2019, the Commission believes that few, if any, would be classified as SRSs pursuant to the Proposed Rule. With respect to Baseline A, the Commission notes that any potential SRSs would have likely classified themselves as conduit affiliates or Other Non-U.S. Persons pursuant to the Guidance. Accordingly, some may incur incremental costs associated with assessing and implementing the additional counting requirements for SRSs. With respect to Baseline B, the Commission believes that most potential SRSs would have interpreted section 2(i) to require them to count their dealing swaps with U.S. persons, but acknowledges that some may not have interpreted section 2(i) so as to require them to count swaps with non-U.S. persons toward their de minimis calculation. Accordingly, such non-U.S. persons would incur the incremental costs of associated with the additional SRS counting requirements contained in the Proposed Rule. The Commission believes that the proposed SRS de minimis calculation requirements would prevent regulatory arbitrage by ensuring that certain entities do not simply book swaps through a non-U.S. affiliate to avoid CFTC registration. Accordingly, the Commission believes that such provisions would benefit the swap market by ensuring that the Dodd-Frank Act swap provisions addressed by the Proposed Rule are applied specifically to entities whose activities, in the aggregate, have a direct and significant connection to, and impact on, U.S. commerce.

(ii) Other Non-U.S. Persons

Under the Proposed Rule, non-U.S. persons that are neither Guaranteed Entities nor SRSs would be required to include in their de minimis threshold calculations swap dealing activities with U.S. persons (other than swaps conducted through a foreign branch of a registered SD) and certain swaps with Guaranteed Entities.[383] The Proposed Rule would not, however, require Other Non-U.S. Persons to include swap dealing transactions with SRSs or Other Non-U.S. Persons. Additionally, Other Non-U.S. Persons would not be required to include in their de minimis calculation any transaction that is executed anonymously on a DCM, registered or exempt SEF, or registered FBOT, and cleared.

[383] Proposed § 23.23(b)(2).

The Commission believes that requiring all non-U.S. persons to include their swap dealing transactions with U.S. persons in their de minimis calculations is necessary to advance the goals of the Dodd-Frank Act SD registration regime, which focuses on U.S. market participants and the U.S. market. As discussed above, the Commission believes it is appropriate to allow Other Non-U.S. Persons to exclude swaps conducted through a foreign branch of a registered SD because, generally, such swaps would be subject to Dodd-Frank Act transactional requirements and, therefore, would not evade the Dodd-Frank Act regime.

Given that these requirements are consistent with the Guidance in most respects, the Commission believes that the Proposed Rule would have a negligible impact on Other Non-U.S. Persons, as measured against Baseline A. With respect to Baseline B, the Commission believes that most non-U.S. persons would have interpreted CEA section 2(i) to require them to count their dealing swaps with U.S. persons, but acknowledges that some non-U.S. persons may not have interpreted 2(i) so as to require them to count such swaps with non-U.S. persons toward their de minimis calculation. Accordingly, such non-U.S. persons would incur the incremental costs associated with the counting requirements for Other Non-U.S. Persons contained in the Proposed Rule.

The Commission recognizes that the Proposed Rule’s cross-border approach to the de minimis threshold calculation could contribute to competitive disparities arising between U.S.-based financial groups and non-U.S. based financial groups. Potential SDs that are U.S. persons, SRSs, or Guaranteed Entities would be required to include all of their swap dealing transactions in their de minimis threshold calculations. In contrast, Other Non-U.S. Persons would be permitted to exclude certain dealing transactions from their de minimis calculations. As a result, Guaranteed Entities and SRSs may be at a competitive disadvantage, as more of their swap activity would apply toward the de minimis threshold (and thereby trigger SD registration) relative to Other Non-U.S. Persons.[384] While the Commission does not believe that any additional Other Non-U.S. Persons would be required to register as a SD under the Proposed Rule, the Commission acknowledges that to the extent that one does, its non-U.S. person counterparties (clients and dealers) may possibly cease transacting with it in order to operate outside the Dodd-Frank Act swap regime.[385] Additionally, unregistered non-U.S. dealers may be able to offer swaps on more favorable terms to non-U.S. persons than their registered competitors because they are not required to incur the costs associated with CFTC registration.[386] As noted above, however, the Commission believes that these competitive disparities would be mitigated to the extent that foreign jurisdictions impose comparable requirements. Given that the Commission has found many foreign jurisdictions comparable with respect to various aspects of the Dodd-Frank Act swap requirements, the Commission believes that such competitive disparities would be negligible.[387] Further, as discussed below, the Commission is proposing to adopt a

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[384] On the other hand, as noted above, the Commission acknowledges that some market participants may prefer to enter into swaps with counterparties that are subject to the swaps provisions adopted pursuant to the Dodd-Frank Act. Further, Guaranteed Entities and SRSs may enjoy other competitive advantages due to the support of their guarantor or ultimate U.S. parent entity.

[385] Additionally, some unregistered dealers may opt to withdraw from the market, thereby contracting the number of dealers competing in the swaps market, which may have an adverse effect on competition and liquidity.

[386] These non-U.S. dealers also may be able to offer swaps on more favorable terms to U.S. persons, giving them a competitive advantage over U.S. competitors with respect to U.S. counterparties.

[387] *See supra* notes 142 and 337.

flexible standard of review for comparability determinations relating to the group B and group C requirements that would be issued pursuant to the Proposed Rule, which would serve to further mitigate any competitive disparities arising out of disparate regulatory regimes. Finally, the Commission reiterates its belief that the cross-border approach to the SD registration threshold taken in the Proposed Rule is appropriately tailored to further the policy objectives of the Dodd-Frank Act while mitigating unnecessary burdens and disruption to market practices to the extent possible.

3. Cross-Border Application of the MSP Registration Thresholds

(i) U.S. Persons, Guaranteed Entities, and SRSs

The Proposed Rule's approach to the cross-border application of the MSP registration threshold closely mirrors the proposed approach for the SD registration threshold. Under the Proposed Rule, a U.S. person would include all of its swap positions in its MSP threshold, without exception.[388] As discussed above, that would include any swap conducted through a U.S. person's foreign branch, as such swaps are directly attributed to, and therefore impact, the U.S. person. Given that this requirement is consistent with the Guidance in this respect, the Commission believes that the Proposed Rule would have a minimal impact on the status quo with regard to the number of potential U.S MSPs, as measured against Baseline A. With respect to Baseline B, all of a U.S. person's swap positions would apply toward the MSP threshold calculation, even absent the Guidance, pursuant to paragraph (6) of the MSP definition.[389] However, the Commission acknowledges that, absent the Guidance, some U.S. persons may not

[388] Proposed § 23.23(c)(1).
[389] 17 CFR 1.3, Major swap participant, paragraph (6).

have interpreted CEA section 2(i) to require them to include swaps conducted through their foreign branches in their MSP threshold calculation. Accordingly, with respect to Baseline B, the Commission expects that some U.S. persons may incur incremental costs as a result of having to count swaps conducted through their foreign branches.

The Proposed Rule would also require Guaranteed Entities to include all of their swap positions in their MSP threshold calculation without exception.[390] This approach, which recognizes that such swap transactions may have the same potential to impact the U.S. financial system as a U.S. person's swap positions, closely parallels the approach taken in the Guidance with respect to "conduit affiliates" and "guaranteed affiliates."[391] The Commission believes that few, if any, additional MSPs would qualify as Guaranteed Entities pursuant to the Proposed Rule, as compared to Baseline A. Accordingly, the Commission believes that, in this respect, any increase in costs associated with the Proposed Rule would be small.

Under the Proposed Rule, an SRS would also include all of its swap positions in its MSP threshold calculation.[392] Under the Guidance, an SRS would likely have been categorized as either a conduit affiliate (which would have been required to count all its swap positions towards its MSP threshold calculation) or an Other Non-U.S. Person (which would have been required to count only a subset of its swap positions towards its MSP threshold calculation). Unlike an Other Non-U.S. Person, SRSs would additionally

[390] Proposed § 23.23(c)(2)(ii).
[391] *See* Guidance, 78 FR *at* 45319-20.
[392] Proposed § 23.23(c)(1).

be required to include in their de minimis calculation any transaction that is executed anonymously on a DCM, registered or exempt SEF, or registered FBOT, and cleared.

As noted in sections II.C and IV.B, the Commission believes that it would be appropriate to distinguish SRSs from Other Non-U.S. Persons in determining the cross-border application of the MSP threshold to such entities, as well as with respect to the Dodd-Frank Act swap provisions addressed by the Proposed Rule more generally. As discussed above, SRSs, as a class of entities, present a greater supervisory interest to the CFTC relative to Other Non-U.S. Persons, due to the nature and extent of the their relationships with their ultimate U.S. parent entities. Therefore, the Commission believes that it is appropriate to require SRSs to include more of their swap positions in their MSP threshold calculation than Other Non-U.S. Persons would. Additionally, allowing an SRS to exclude all of its non-U.S. swap positions from its calculation could incentivize U.S. financial groups to book their non-U.S. positions into a non-U.S. subsidiary to avoid MSP registration requirements. Given that this requirement was not included in the Guidance or the Cross-Border Margin Rule, the Commission believes that this aspect of the Proposed Rule would have a similar impact on market participants when measured against Baseline A and Baseline B. The Commission notes that there are no MSPs registered with the Commission, and expects that few entities would be required to undertake an assessment to determine whether they would qualify as an MSP under the Proposed Rule. Any such entities would likely have classified themselves as Other Non-U.S. Persons pursuant to the Guidance. Accordingly, they may incur incremental costs associated with assessing and implementing the additional counting requirements for

SRSs. With respect to Baseline B, the Commission believes that most potential SRSs would have interpreted CEA section 2(i) to require them to count their swap positions with U.S. persons, but acknowledges that some may not have interpreted CEA section 2(i) so as to require them to count swap positions with non-U.S. persons toward their MSP threshold calculation. Accordingly, such SRSs would incur the incremental costs associated with the additional SRS counting requirements contained in the Proposed Rule. The Commission believes that these proposed SRS calculation requirements would mitigate regulatory arbitrage by ensuring that U.S. entities do not simply book swaps through an SRS affiliate to avoid CFTC registration. Accordingly, the Commission believes that such provisions would benefit the swap market by ensuring that the Dodd-Frank Act swap requirements that are addressed by the Proposed Rule are applied to entities whose activities have a direct and significant connection to, and impact on, the U.S. markets.

(ii) Other Non-U.S. Persons

Under the Proposed Rule, Other Non-U.S. Persons would be required to include in their MSP calculations swap positions with U.S. persons (other than swaps conducted through a foreign branch of a registered SD) and certain swaps with Guaranteed Entities.[393] The Proposed Rule would not, however, require Other Non-U.S. Persons to include swap positions with SRSs or Other Non-U.S. Persons. Additionally, Other Non-U.S. Persons would not be required to include in their MSP threshold calculation any

[393] Proposed § 23.23(c)(2).

transaction that is executed anonymously on a DCM, a registered or exempt SEF, or registered FBOT, and cleared.[394]

Given that these requirements are consistent with the Guidance in most respects, the Commission believes that the Proposed Rule would have a minimal impact on Other Non-U.S. Persons, as measured against Baseline A. With respect to Baseline B, the Commission believes that most non-U.S. persons would have interpreted CEA section 2(i) to require them to count their swap positions with U.S. persons, but acknowledges that some non-U.S. persons may not have interpreted CEA section 2(i) so as to require them to count swaps with non-U.S. persons toward their MSP threshold calculation. Accordingly, such non-U.S. persons would incur the incremental costs of associated with the counting requirements for Other Non-U.S. Persons contained in the Proposed Rule.

The Commission recognizes that the Proposed Rule's cross-border approach to the MSP threshold calculation could contribute to competitive disparities arising between U.S.-based financial groups and non-U.S. based financial groups. Potential MSPs that are U.S. persons, SRSs, or Guaranteed Entities would be required to include all of their swap positions. In contrast, Other Non-U.S. Persons would be permitted to exclude certain swap positions from their MSP threshold calculations. As a result, SRSs and Guaranteed Entities may be at a competitive disadvantage, as more of their swap activity would apply toward the MSP calculation and trigger MSP registration relative to Other Non-U.S. Persons. While the Commission does not believe that any additional Other Non-U.S. Persons would be required to register as an MSP under the Proposed Rule, the

[394] Proposed § 23.23(d).

Commission acknowledges that to the extent that a currently unregistered non-U.S. person would be required to register as an MSP under the Proposed Rule, its non-U.S. persons may possibly cease transacting with it in order to operate outside the Dodd-Frank Act swap regime.[395] Additionally, unregistered non-U.S. persons may be able to enter into swaps on more favorable terms to non-U.S. persons than their registered competitors because they are not required to incur the costs associated with CFTC registration.[396] As noted above, however, the Commission believes that these competitive disparities would be mitigated to the extent that foreign jurisdictions impose comparable requirements. Further, the Commission reiterates its belief that the cross-border approach to the MSP registration threshold taken in the Proposed Rule aims to further the policy objectives of the Dodd-Frank Act while mitigating unnecessary burdens and disruption to market practices to the extent possible.

4. Monitoring Costs

Under the Proposed Rule, market participants would need to continue to monitor their swap activities in order to determine whether they are, or continue to be, required to register as an SD or MSP. With respect to Baseline A, the Commission believes that market participants have developed policies and practices consistent with the cross-border approach to the SD and MSP registration thresholds expressed in the Guidance. Therefore the Commission believes that market participants would only incur incremental

[395] Additionally, some unregistered swap market participants may opt to withdraw from the market, thereby contracting the number of competitors in the swaps market, which may have an effect on competition and liquidity.
[396] These non-U.S. market participants also may be able to offer swaps on more favorable terms to U.S. persons, giving them a competitive advantage over U.S. competitors with respect to U.S. counterparties.

costs in modifying their existing systems and policies and procedures in response to the Proposed Rule (*e.g.*, determining which swap activities or positions would be required to be included in the registration threshold calculations).[397]

For example, the Commission notes that SRSs may have adopted policies and practices in line with the Guidance's approach to non-U.S. persons that are not guaranteed or conduit affiliates and therefore may only be currently counting (or be provisionally registered by virtue of) their swap dealing transactions with U.S. persons, other than foreign branches of U.S. SDs. Although an SRS would be required under the Proposed Rule to include all dealing swaps in its de minimis calculation, the Commission believes that any increase in monitoring costs for SRSs would be negligible, both initially and on an ongoing basis, because they already have systems that track swap dealing transactions with certain counterparties in place, which includes an assessment of their counterparties' status.[398] The Commission expects that any adjustments made to these systems in response to the Proposed Rule would be minor.

With respect to Baseline B, the Commission believes that, absent the Guidance, most market participants would have interpreted CEA section 2(i) to require them, at a minimum, to monitor their swap activities with U.S. persons to determine whether they are, or continue to be, required to register as an SD or MSP. Therefore, the Commission believes that certain market participants may incur incremental costs in modifying their

[397] Although the cross-border approach to the MSP registration threshold calculation in the Proposed Rule is not identical to the approach included in the Guidance (*see supra* section IV.B.2), the Commission believes that any resulting increase in monitoring costs resulting from the Proposed Rule being adopted would be incremental and de minimis.
[398] *See supra* section VIII.C.1, for a discussion of assessment costs.

existing systems and policies and procedures in response to the Proposed Rule to monitor their swap activity with non-U.S. persons.

5. Registration Costs

With respect to Baseline A, the Commission believes that few, if any, additional non-U.S. persons would be required to register as a SD pursuant to the Proposed Rule. With respect to Baseline B, the Commission acknowledges that, absent the Guidance, some non-U.S. persons may not have interpreted CEA section 2(i) so as to require them to register with the Commission. Accordingly, a subset of such entities may be required to register with the Commission pursuant to the Proposed Rule, if adopted.

The Commission acknowledges that if a market participant were required to register, it may incur registration costs. The Commission previously estimated registration costs in its rulemaking on registration of SDs;[399] however, the costs that may be incurred should be mitigated to the extent that these new SDs are affiliated with an existing SD, as most of these costs have already been realized by the consolidated group. While the Commission cannot anticipate the extent to which any potential new registrants would be affiliated with existing SDs, it notes that most current registrants are part of a consolidated group. The Commission has not included any discussion of registration costs for MSPs because it believes that few, if any, market participants would be required to register as an MSP under the Proposed Rule, as noted above.

[399] *See* Registration of Swap Dealers and Major Swap Participants, 77 FR at 2623-25.

6. Programmatic Costs

With respect to Baseline A, as noted above, the Commission believes that few, if any, additional non-U.S. persons would be required to register as a SD under the Proposed Rule. With respect to Baseline B, the Commission acknowledges that, absent the Guidance, some non-U.S. persons may not have interpreted CEA section 2(i) so as to require them to register with the Commission. Accordingly, a subset of such entities may be required to register with the Commission pursuant to the Proposed Rule, if adopted.

To the extent that the Proposed Rule acts as a "gating" rule by affecting which entities engaged in cross-border swap activities must comply with the SD requirements, the Proposed Rule, if adopted, could result in increased costs for particular entities that otherwise would not register as an SD and comply with the swap provisions.[400]

7. Proposed Exceptions from Group B and Group C Requirements, Availability of Substituted Compliance, and Comparability Determinations

As discussed in section VI above, the Commission, consistent with section 2(i) of the CEA, is proposing exceptions from, and substituted compliance for, certain group A, group B, and group C requirements applicable to swap entities, as well as the creation of a framework for comparability determinations.

(i) Exceptions

Specifically, as discussed above in section VI, the Proposed Rule includes: (1) the Exchange-Traded Exception from certain group B and group C requirements for certain

[400] As noted above, the Commission believes that, if the Proposed Rule is adopted, few (if any) market participants would be required to register as an MSP under the Proposed Rule, and therefore it has not included a separate discussion of programmatic costs for registered MSPs in this section.

anonymously executed, exchange-traded, and cleared foreign-based swaps; (2) the Foreign Swap Group C Exception for certain foreign-based swaps with foreign counterparties; (3) the Non-U.S. Swap Entity Group B Exception for foreign-based swaps of certain non-U.S. swap entities with certain foreign counterparties; and (4) the Foreign Branch Group B Exception for certain foreign-based swaps of foreign branches of U.S. swap entities with certain foreign counterparties.[401]

Under the Proposed Rule, U.S. swap entities (other than their foreign branches) would not be excepted from, or eligible for substituted compliance for, the Commission's group A, group B, and group C requirements. This reflects the Commission's view that these requirements should apply fully to registered SDs and MSPs that are U.S. persons because their swap activities are particularly likely to affect the integrity of the swap market in the United States and raise concerns about the protection of participants in those markets. With respect to both baselines, the Commission does not expect that this would impose any additional costs on market participants given that the Commission's relevant business conduct requirements already apply to U.S. SDs and MSPs pursuant to existing Commission regulations.

Pursuant to the Exchange-Traded Exception, non-U.S. swap entities and foreign branches of non-U.S. swap entities would generally be excluded from the group B and group C requirements with respect to their foreign-based swaps that are anonymously executed, exchange-traded, and cleared.

[401] As discussed above, these exceptions are similar to ones provided in the Guidance.

Further, pursuant to the Foreign Swap Group C Exception, non-U.S. swap entities and foreign branches of U.S. swap entities would be excluded from the group C requirements with respect to their foreign-based swaps with foreign counterparties.

In addition, pursuant to the Non-U.S. Swap Entity Group B Exception, non-U.S. swap entities that are neither SRSs nor Guaranteed Entities would be excepted from the group B requirements with respect to any foreign-based swap with foreign counterparties that are neither SRSs nor Guaranteed Entities.

Finally, pursuant to the Foreign Branch Group B Exception, foreign branches of U.S. swap entities would be excepted from the group B requirements, with respect to any foreign-based swap with a foreign counterparty that is an Other Non-U.S. Person, subject to certain limitations. Specifically, the exception would not be available with respect to any group B requirement for which substituted compliance is available for the relevant swap, and in any calendar quarter, the aggregate gross notional amount of swaps conducted by a U.S. swap entity in reliance on the exception may not exceed five percent of the aggregate gross notional amount of all its swaps.

The Commission acknowledges that the group B requirements may apply more broadly to swaps between non-U.S. persons than as contemplated in the Guidance. Specifically, the Proposed Rule would require swap entities that are either Guaranteed Entities or SRSs to comply with the group B requirements for swaps with Other Non-U.S. Persons, whereas the Guidance stated that all non-U.S. swap entities (other than their U.S. branches) were excluded from the group B requirements with respect to swaps with a non-U.S. person that is not a guaranteed or conduit affiliate. However, the

Commission believes that the proposed exceptions, coupled with the availability of substituted compliance, would help to alleviate any additional burdens that may arise from such application. Notwithstanding the availability of these exceptions and substituted compliance, the Commission acknowledges that some non-U.S. swap entities may incur costs to the extent that a comparability determination has not yet been issued for certain jurisdictions. Further, the Commission expects that swap entities that avail themselves of the proposed exceptions would be able to reduce their costs of compliance with respect to the excepted requirements (which, to the extent they are similar to requirements in the jurisdiction in which they are based, may be potentially duplicative or conflicting). The Commission notes that swap entities are not required to take any additional action to avail themselves of these exceptions (*e.g.*, notification to the Commission) that would cause them to incur additional costs. The Commission recognizes that the exceptions (and the inherent cost savings) may give certain swap entities a competitive advantage with respect to swaps that meet the requirements of the exception.[402] The Commission nonetheless believes that it is appropriate to tailor the application of the group B and group C requirements in the cross-border context, consistent with section 2(i) of the CEA and international comity principles, so as to except these foreign-based swaps from the relevant requirements. In doing so, the Commission is aiming to reduce market fragmentation which may result by applying certain duplicative swap requirements in non-U.S. markets, which are often subject to robust foreign regulation. The Commission notes that the proposed exceptions are

[402] The degree of competitive disparity will depend on the degree of disparity between the Commission's requirements and that of the relevant foreign jurisdiction.

similar to those provided in the Guidance. Therefore, the Commission does not expect such exceptions would have a significant impact on the costs of, and benefits to, swap entities.

(ii) Substituted Compliance

As described in section VI.C, the extent to which substituted compliance is available under the Proposed Rule would depend on the classification of the swap entity or branch and, in certain cases the counterparty, to a particular swap. The Commission recognizes that the decision to offer any substituted compliance carries certain trade-offs. Given the global and highly-interconnected nature of the swap market, where risk is not bound by national borders, market participants are likely to be subject to the regulatory interest of more than one jurisdiction. Allowing compliance with foreign swap requirements as an alternative to compliance with the Commission’s requirements can therefore reduce the application of duplicative or conflicting requirements, resulting in lower compliance costs and potentially facilitating a more efficient regulatory framework over time as regulatory regimes compete to have swap transactions occur in their respective jurisdictions. Substituted compliance also helps preserve the benefits of an integrated, global swap market by fostering and advancing efforts among U.S. and foreign regulators to collaborate in establishing robust regulatory standards. If not properly implemented, however, the Commission's swap regime could lose some of its effectiveness. Accordingly, the ultimate costs and benefits of substituted compliance are affected by the standard under which it is granted and the extent to which it is applied. The Commission was mindful of this dynamic in structuring a proposed substituted compliance regime for the group A and group B requirements and believes the Proposed Rule strikes an appropriate balance, enhancing market efficiency and fostering global coordination of these requirements while ensuring that swap entities (wherever located) are subject to comparable regulation.

The Commission also understands that by not offering substituted compliance equally to all swap entities, the Proposed Rule, if adopted, could lead to certain competitive disparities between swap entities. For example, to the extent that a non-U.S. swap entity can rely on substituted compliance that is not available to a U.S. swap entity, it may enjoy certain cost advantages (*e.g.*, avoiding the costs of potentially duplicative or inconsistent regulation). The non-U.S. swap entity may then be able to pass on these cost savings to their counterparties in the form of better pricing or some other benefit. U.S. swap entities, on the other hand, could, depending on the extent to which foreign swap requirements apply, be subject to both U.S. and foreign requirements, and therefore be at a competitive disadvantage. Counterparties may also be incentivized to transact with swap entities that are offered substituted compliance in order to avoid being subject to duplicative or conflicting swap requirements, which could lead to increased market deficiencies.[403]

Nevertheless, the Commission does not believe it is appropriate to make substituted compliance broadly available to all swap entities. As discussed above, the Commission has a strong supervisory interest in the swap activity of all swap entities,

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[403] The Commission recognizes that its proposed framework, if adopted, may impose certain initial operational costs, as in certain cases swap entities will be required to determine the status of their counterparties in order to determine the extent to which substituted compliance is available.

including non-U.S. swap entities, by virtue of their registration with the Commission. Further, U.S. swap entities are particularly key swap market participants and their safety and soundness is critical to a well-functioning U.S. swap market and the stability of the U.S. financial system. The Commission believes that losses arising from the default of a U.S. entity are more likely to be borne by other U.S. entities (including parent companies); therefore a U.S. entity's risk to the U.S. financial system is more acute than that of a similarly situated non-U.S. entity. Accordingly, in light of the Commission's supervisory interest in the activities of U.S. persons and its statutory obligation to ensure the safety and soundness of swap entities and the U.S. swap market, the Commission believes that it is generally not appropriate for substituted compliance to be available to U.S. swap entities for purposes of the Proposed Rule. With respect to non-U.S. swap entities, however, the Commission believes that, in the interest of international comity, making substituted compliance broadly available for the requirements discussed in the Proposed Rule is appropriate.

(iii) Comparability Determinations

As noted in section VI.D above, under the Proposed Rule, a comparability determination may be requested by: (1) eligible swap entities; (2) trade associations whose members are eligible swap entities; or (3) foreign regulatory authorities that have direct supervisory authority over eligible swap entities and are responsible for administering the relevant foreign jurisdiction's swap requirements.[404] Once a comparability determination is made for a jurisdiction, it applies for all entities or

[404] Proposed § 23.23(g)(2).

transactions in that jurisdiction to the extent provided in the determination, as approved by the Commission.[405] Accordingly, given that the Proposed Rule would have no impact on any existing comparability determinations, swap entities could continue to rely on such determinations with no impact on the costs or benefits of such reliance. To the extent that an entity wishes to request a new comparability determination pursuant to the Proposed Rule, it would incur costs associated with the preparation and filing of submission requests. However, the Commission anticipates that a person would not elect to incur the costs of submitting a request for a comparability determination unless such costs were exceeded by the cost savings associated with substituted compliance.

The Proposed Rule includes a standard of review that allows for a holistic, outcomes-based approach that enables the Commission to consider any factor it deems relevant in assessing comparability. Further, in determining whether a foreign regulatory requirement is comparable to a corresponding Commission requirement, the Proposed Rule would allow the Commission to consider the broader context of a foreign jurisdiction's related regulatory requirements. Allowing for a comparability determination to be made based on comparable outcomes and objectives, notwithstanding potential differences in foreign jurisdictions' relevant standards, helps to ensure that substituted compliance is made available to the fullest extent possible. While the Commission recognizes that, to the extent that a foreign swap regime is not deemed comparable in all respects, swap entities eligible for substituted compliance may incur costs from being required to comply with more than one set of specified swap

[405] Proposed § 23.23(f).

requirements, the Commission believes that this approach is preferable to an all-or-nothing approach, in which market participants may be forced to comply with both regimes in their entirety.

8. Recordkeeping

The Proposed Rule would also require swap entities to create and retain records of their compliance with the Proposed Rule. Given that swap entities are already subject to robust recordkeeping requirements, the Commission believes that, if the Proposed Rule is adopted, swap entities would only incur incremental costs, which are expected to be minor, in modifying their existing systems and policies and procedures resulting from changes to the status quo made by the Proposed Rule.

9. Section 15(a) Factors

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) factors.

(i) Protection of Market Participants and the Public

The Commission believes the Proposed Rule would support protection of market participants and the public. By focusing on and capturing swap dealing transactions and swap positions involving U.S. persons, SRSs, and Guaranteed Entities, the Proposed Rule's approach to the cross-border application of the SD and MSP registration threshold calculations would work to ensure that, consistent with CEA section 2(i) and the policy objectives of the Dodd-Frank Act, significant participants in the U.S. market are subject to these requirements. The proposed cross-border approach to the group A, group B, and group C requirements similarly ensures that these requirements would apply to swap activities that are particularly likely to affect the integrity of and raise concerns about the protection of participants in the U.S. market while, consistent with principles of international comity, recognizing the supervisory interests of the relevant foreign jurisdictions in applying their own requirements to transactions involving non-U.S. swap entities and foreign branches of U.S. swap entities with non-U.S. persons and foreign branches of U.S. swap entities.

(ii) Efficiency, Competitiveness, and Financial Integrity of the Markets

To the extent that the Proposed Rule leads additional entities to register as SDs or MSPs, the Commission believes that the Proposed Rule could enhance the financial integrity of the markets by bringing significant U.S. swap market participants under Commission oversight, which may reduce market disruptions and foster confidence and transparency in the U.S. market. The Commission recognizes that, if adopted, the Proposed Rule's cross-border approach to the SD and MSP registration thresholds may create competitive disparities among market participants, based on the degree of their connection to the United States, that could contribute to market deficiencies, including market fragmentation and decreased liquidity, as certain market participants may reduce their exposure to the U.S. market. As a result of reduced liquidity, counterparties may pay higher prices, in terms of bid-ask spreads. Such competitive effects and market deficiencies may, however, be mitigated by global efforts to harmonize approaches to swap regulation and by the large inter-dealer market, which may link the fragmented markets and enhance liquidity in the overall market. The Commission believes that the Proposed Rule's approach is necessary and appropriately tailored to ensure that the purposes of the Dodd-Frank Act swap regime and its registration requirements are advanced while still establishing a workable approach that recognizes foreign regulatory interests and reduces competitive disparities and market deficiencies to the degree possible. The Commission further believes that the Proposed Rule's cross-border approach to the group A, group B, and group C requirements would promote the financial integrity of the markets by fostering transparency and confidence in the major participants in the U.S. swap markets.

(iii) Price Discovery

The Commission recognizes that, if adopted, the Proposed Rule's approach to the cross-border application of the SD and MSP registration thresholds and group A, group B, and group C requirements could also have an effect on liquidity, which may in turn influence price discovery. As liquidity in the swap market is lessened and fewer dealers compete against one another, bid-ask spreads (cost of swap and cost to hedge) may widen and the ability to observe an accurate price of a swap may be hindered. However, as noted above, these negative effects would be mitigated as jurisdictions harmonize their swap initiatives and global financial institutions continue to manage their swap books (*i.e.*, moving risk with little or no cost, across an institution to market centers, where there is the greatest liquidity). The Commission does not believe that, if adopted, the Proposed Rule's approach to the group A, group B, and group C requirements, however, will have a noticeable impact on price discovery.

(iv) Sound Risk Management Practices

The Commission believes that, if adopted, the Proposed Rule's approach could promote the development of sound risk management practices by ensuring that significant participants in the U.S. market are subject to Commission oversight (via registration), including in particular important counterparty disclosure and recordkeeping requirements that will encourage policies and practices that promote fair dealing while discouraging abusive practices in U.S. markets. On the other hand, to the extent that a registered SD or MSP relies on the exceptions proposed in this release, and is located in a jurisdiction that does not have comparable swap requirements, the Proposed Rule could lead to weaker risk management practices for such entities.

(v) Other Public Interest Considerations

The Commission believes that the Proposed Rule is consistent with the principles of international comity.

10. Request for Comment

The Commission invites comment on all aspects of the costs and benefits associated with the Proposed Rule, and specifically requests comments on the following questions. Please explain your responses.

(42) Would additional market participants be required to register as SDs (compared to the status quo) as a result of the Proposed Rule being adopted? If so, please provide an estimate for the number of such market participants. Please include an explanation for the basis of the estimate, and associated costs and benefits of the Proposed Rule's provisions for SDs (including potential SDs).

(43) Would any market participants be required to register as an MSP as a result of the Proposed Rule being adopted? If so, please provide an estimate for the number of such market participants. Please include an explanation for the basis of the estimate, and associated costs and benefits of the Proposed Rule's provisions for potential MSPs.

(44) The Proposed Rule would not provide relief to swap entities that are SRSs or Guaranteed Entities from the group B requirements for transactions facing Other Non-U.S. Persons. Thus, under the Proposed Rule, SRSs and Guaranteed Entities would generally be required to comply with the group B requirements for all of their swaps, rely on existing substituted compliance determinations, or seek additional substituted compliance determinations. Please provide an estimate for the number of swap entities that would be likely to incur compliance costs as a result of this aspect of the Proposed Rule, as well as an estimate of the associated costs and benefits of such provision. To what extent would the proposed availability of substituted compliance in such instances affect these costs and benefits?

(45) The Commission invites information regarding whether and the extent to which specific foreign requirement(s) may affect the costs and benefits of the Proposed

Rule, including information identifying the relevant foreign requirement(s) and any monetary or other quantitative estimates of the potential magnitude of those costs and benefits.

(46) Would the proposed recordkeeping provision cause registrants to incur more than a minor incremental cost to implement? If so, please provide an estimate for such costs. Please include an explanation for the basis of the estimate, and associated costs and benefits of the Proposed Rule's recordkeeping provisions.

D. Antitrust Considerations

Section 15(b) of the CEA[406] requires the Commission to "take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives of [the CEA], as well as the policies and purposes of [the CEA], in issuing any order or adopting any Commission rule or regulation (including any exemption under section 4(c) or 4c(b), or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to section 17 of [the CEA]."

The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition. The Commission requests comment on whether the Proposed Rule implicates any other specific public interest to be protected by the antitrust laws.

The Commission has considered the Proposed Rule to determine whether it is anticompetitive and has preliminarily identified no anticompetitive effects. The

[406] 7 U.S.C. 19(b).

Commission requests comment on whether the Proposed Rule is anticompetitive and, if it is, what the anticompetitive effects are.

Because the Commission has preliminarily determined that the Proposed Rule is not anticompetitive and has no anticompetitive effects, the Commission has not identified any less anticompetitive means of achieving the purposes of the CEA. The Commission requests comment on whether there are less anticompetitive means of achieving the relevant purposes of the CEA that would otherwise be served by adopting the Proposed Rule.

IX. Preamble Summary Tables

A. Table A – Cross-Border Application of the SD De Minimis Threshold

Table A should be read in conjunction with the text of the Proposed Rule.

Counterparty → / Potential SD ↓		U.S. Person	Non-U.S. Person		
			Guaranteed Entity	SRS	Other Non-U.S. Person
U.S. Person		Include	Include	Include	Include
Non-U.S. Person	Guaranteed Entity	Include	Include	Include	Include
	SRS	Include	Include	Include	Include
	Other Non-U.S. Person[1]	Include[2]	Include[3]	Exclude	Exclude

[1] Would not include swaps entered into anonymously on a DCM, a registered SEF or a SEF exempted from registration, or a registered FBOT and cleared through a registered DCO or a DCO exempted from registration.
[2] Unless the swap is conducted through a foreign branch of a registered SD.
[3] Unless the Guaranteed Entity is registered as an SD, or unless the guarantor is a non-financial entity.

B. Table B – Cross-Border Application of the MSP Threshold

Table B should be read in conjunction with the text of the Proposed Rule.

Counterparty → / Potential MSP ↓		U.S. Person	Non-U.S. Person		
			Guaranteed Entity	SRS	Other Non-U.S. Person
U.S. Person		Include	Include	Include	Include
Non-U.S. Person	Guaranteed Entity	Include	Include	Include	Include
	SRS	Include	Include	Include	Include
	Other Non-U.S. Person[1]	Include[2]	Include[3]	Exclude	Exclude

[1] Would not include swap positions entered into anonymously on a DCM, a registered SEF or a SEF exempted from registration, or a registered FBOT and cleared through a registered DCO or a DCO exempted from registration.
[2] Unless the swap is conducted through a foreign branch of a registered SD.
[3] Unless the Guaranteed Entity is registered as an SD.
Additionally, all swap positions that are subject to recourse should be attributed to the guarantor, whether it is a U.S. person or a non-U.S. person, unless the guarantor, the Guaranteed Entity, and its counterparty are Other Non-U.S. Persons.

C. Table C – Cross-Border Application of the Group B Requirements in Consideration of Related Exceptions and Substituted Compliance

Table C[407] should be read in conjunction with the text of the Proposed Rule.

Counterparty →	U.S. Person		Non-U.S. Person		
	Non-Foreign Branch	Foreign Branch	U.S. Branch	Guaranteed Entity or SRS	Other Non-U.S. Persons

[407] As discussed in section VI.A.2, the group B requirements are set forth in §§ 23.202, 23.501, 23.502, 23.503, and 23.504 and relate to (1) swap trading relationship documentation; (2) portfolio reconciliation and compression; (3) trade confirmation; and (4) daily trading records. Proposed exceptions from the group B requirements are discussed in section VI.B.1, 3, and 4. Proposed substituted compliance for the group B requirements is discussed in section VI.C.2.

Swap Entity ↓						
U.S. Swap Entity	Non-Foreign Branch	Yes	Yes	Yes	Yes	Yes
	Foreign Branch	Yes[1]	Yes[1] *Sub. Comp. Available*	Yes[1]	Yes[1] *Sub. Comp. Available*	Yes[1, 2] *Sub. Comp. Available*
Non-U.S. Swap Entity	U.S. Branch	Yes	Yes	Yes	Yes	Yes
	Guaranteed Entity or SRS	Yes[1]	Yes[1] *Sub. Comp. Available*	Yes[1]	Yes[1] *Sub. Comp. Available*	Yes[1] *Sub. Comp. Available*
	Other Non-U.S. Persons	Yes[1]	Yes[1] *Sub. Comp. Available*	Yes[1]	Yes[1] *Sub. Comp. Available*	No

[1] Under the Proposed Rule, the Exchange-Traded Exception would be available from certain group B and C requirements for certain anonymous, exchange-traded, and cleared foreign-based swaps between the listed parties.
[2] Under the Proposed Rule the Foreign Branch Group B Exception would be available from the group B requirements for a foreign branch's foreign-based swaps with a foreign counterparty that is an Other Non-U.S. Person.

D. Table D – Cross-Border Application of the Group C Requirements in Consideration of Related Exceptions

Table D[408] should be read in conjunction with the text of the Proposed Rule.

[408] As discussed in section VI.A.3, the group C requirements are set forth in §§ 23.400-451 and relate to certain business conduct standards governing the conduct of SDs and MSPs in dealing with their swap counterparties. Proposed exceptions from the group C requirements are discussed in section VI.B.1 and 2.

Counterparty → / Swap Entity ↓		U.S. Person		Non-U.S. Person		
		Non-Foreign Branch	Foreign Branch	U.S. Branch	Guaranteed Entity or SRS	Other Non-U.S. Persons
U.S. Swap Entity	Non-Foreign Branch	Yes	Yes	Yes	Yes	Yes
	Foreign Branch	Yes[1]	No	Yes[1]	No	No
Non-U.S. Swap Entity	U.S. Branch	Yes	Yes	Yes	Yes	Yes
	Guaranteed Entity or SRS	Yes[1]	No	Yes[1]	No	No
	Other Non-U.S. Persons	Yes[1]	No	Yes[1]	No	No

[1] Under the Proposed Rule the Exchange-Traded Exception would be available from certain group B and C requirements for certain anonymous, exchange-traded, and cleared foreign-based swaps between the listed parties.

List of Subjects

17 CFR Part 23

Business conduct standards, Counterparties, Cross-border, Definitions, De minimis exception, Major swap participants, Swaps, Swap Dealers.

For the reasons stated in the preamble, the Commodity Futures Trading Commission proposes to amend 17 CFR part 23 as follows:

PART 23—SWAP DEALERS AND MAJOR SWAP PARTICIPANTS

1. The authority citation for part 23 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 6, 6a, 6b, 6b-1, 6c, 6p, 6r, 6s, 6t, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21

Section 23.160 also issued under 7 U.S.C. 2(i); Sec. 721(b), Pub. L. 111-203, 124 Stat. 1641 (2010).

2. Add § 23.23 to read as follows:

§ 23.23 Cross-border application.

(a) *Definitions.* For purposes of this section the terms below have the following meanings. A person may rely on a written representation from its counterparty that the counterparty does or does not satisfy the criteria for one or more of the definitions below, unless such person knows or has reason to know that the representation is not accurate; for the purposes of this rule a person would have reason to know the representation is not accurate if a reasonable person should know, under all of the facts of which the person is aware, that it is not accurate.

(1) *Control* including the terms controlling, controlled by, and under common control with, means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting shares, by contract, or otherwise.

(2) *Foreign branch* means any office of a U.S. bank that:

(i) Is located outside the United States;

(ii) Operates for valid business reasons;

(iii) Maintains accounts independently of the home office and of the accounts of other foreign branches, with the profit or loss accrued at each branch determined as a separate item for each foreign branch; and

(iv) Is engaged in the business of banking and is subject to substantive regulation in banking or financing in the jurisdiction where it is located.

(3) *Foreign counterparty* means:

(i) A non-U.S. person, except with respect to a swap conducted through a U.S. branch of that non-U.S. person; or

(ii) A foreign branch where it enters into a swap in a manner that satisfies the definition of a swap conducted through a foreign branch.

(4) *Foreign-based swap* means:

(i) A swap by a non-U.S. swap entity, except for a swap conducted through a U.S. branch; or

(ii) A swap conducted through a foreign branch.

(5) *Group A requirements* mean the requirements set forth in §§ 3.3, 23.201, 23.203, 23.600, 23.601, 23.602, 23.603, 23.605, 23.606, 23.607, and 23.609 of this chapter.

(6) *Group B requirements* mean the requirements set forth in §§ 23.202 and 23.501-504.

(7) *Group C requirements* mean the requirements set forth in §§ 23.400-451.

(8) *Guarantee* means an arrangement pursuant to which one party to a swap has rights of recourse against a guarantor, with respect to its counterparty's obligations under

the swap. For these purposes, a party to a swap has rights of recourse against a guarantor if the party has a conditional or unconditional legally enforceable right to receive or otherwise collect, in whole or in part, payments from the guarantor with respect to its counterparty's obligations under the swap. In addition, in the case of any arrangement pursuant to which the guarantor has a conditional or unconditional legally enforceable right to receive or otherwise collect, in whole or in part, payments from any other guarantor with respect to the counterparty's obligations under the swap, such arrangement will be deemed a guarantee of the counterparty's obligations under the swap by the other guarantor.

(9) *Non-U.S. person* means any person that is not a U.S. person.

(10) *Non-U.S. swap entity* means a swap entity that is not a U.S. swap entity.

(11) *Parent entity* means any entity in a consolidated group that has one or more subsidiaries in which the entity has a controlling interest, as determined in accordance with U.S. GAAP.

(12) *Significant risk subsidiary* means any non-U.S. significant subsidiary of an ultimate U.S. parent entity where the ultimate U.S. parent entity has more than $50 billion in global consolidated assets, as determined in accordance with U.S. GAAP at the end of the most recently completed fiscal year, but excluding non-U.S. subsidiaries that are:

(i) Subject to consolidated supervision and regulation by the Board of Governors of the Federal Reserve System as a subsidiary of a U.S. bank holding company; or

(ii) Subject to capital standards and oversight by the subsidiary's home country supervisor that are consistent with the Basel Committee on Banking Supervision's "International Regulatory Framework for Banks" and subject to margin requirements for uncleared swaps in a jurisdiction for which the Commission has issued a comparability determination.

(13) *Significant subsidiary* means a subsidiary, including its subsidiaries, which meets any of the following conditions:

(i) The three year rolling average of the subsidiary's equity capital is equal to or greater than five percent of the three year rolling average of the ultimate U.S. parent entity's consolidated equity capital, as determined in accordance with U.S. GAAP as of the end of the most recently completed fiscal year;

(ii) The three year rolling average of the subsidiary's total revenue is equal to or greater than ten percent of the three year rolling average of the ultimate U.S. parent entity's total consolidated revenue, as determined in accordance with U.S. GAAP as of the end of the most recently completed fiscal year; or

(iii) The three year rolling average of the subsidiary's total assets is equal to or greater than ten percent of the three year rolling average of the ultimate U.S. parent entity's total consolidated assets, as determined in accordance with U.S. GAAP as of the end of the most recently completed fiscal year.

(14) *Subsidiary* means a subsidiary of a specified person that is an affiliate controlled by such person directly, or indirectly through one or more intermediaries. For purposes of this definition, an affiliate of, or a person affiliated with, a specific person is

a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.

(15) *Swap entity* means a person that is registered with the Commission as a swap dealer or major swap participant pursuant to the Act.

(16) *Swap conducted through a foreign branch* means a swap entered into by a foreign branch where:

(i) The foreign branch or another foreign branch is the office through which the U.S. person makes and receives payments and deliveries under the swap pursuant to a master netting or similar trading agreement, and the documentation of the swap specifies that the office for the U.S. person is such foreign branch;

(ii) The swap is entered into by such foreign branch in its normal course of business; and

(iii) The swap is reflected in the local accounts of the foreign branch.

(17) *Swap conducted through a U.S. branch* means a swap entered into by a U.S. branch where:

(i) The U.S. branch is the office through which the non-U.S. person makes and receives payments and deliveries under the swap pursuant to a master netting or similar trading agreement, and the documentation of the swap specifies that the office for the non-U.S. person is such U.S. branch; or

(ii) The swap is reflected in the local accounts of the U.S. branch.

(18) *Ultimate U.S. parent entity* means the U.S. parent entity that is not a subsidiary of any other U.S. parent entity.

(19) *United States and U.S.* means the United States of America, its territories and possessions, any State of the United States, and the District of Columbia.

(20) *U.S. branch* means a branch or agency of a non-U.S. banking organization where such branch or agency:

(i) Is located in the United States;

(ii) Maintains accounts independently of the home office and other U.S. branches, with the profit or loss accrued at each branch determined as a separate item for each U.S. branch; and

(iii) Engages in the business of banking and is subject to substantive banking regulation in the state or district where located.

(21) *U.S. GAAP* means U.S. generally accepted accounting principles.

(22) *U.S. person*: (i) Except as provided in paragraph (a)(22)(iii) of this section, U.S. person means any person that is:

(A) A natural person resident in the United States;

(B) A partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the United States or having its principal place of business in the United States;

(C) An account (whether discretionary or non-discretionary) of a U.S. person; or

(D) An estate of a decedent who was a resident of the United States at the time of death.

(ii) For purposes of this section, principal place of business means the location from which the officers, partners, or managers of the legal person primarily direct, control, and coordinate the activities of the legal person. With respect to an externally managed investment vehicle, this location is the office from which the manager of the vehicle primarily directs, controls, and coordinates the investment activities of the vehicle.

(iii) The term U.S. person does not include the International Monetary Fund, the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the United Nations, and their agencies and pension plans, and any other similar international organizations, their agencies and pension plans.

(iv) Notwithstanding paragraph (a)(22)(i) of this section, until December 31, 2025, a person may continue to classify counterparties as U.S. persons based on representations that were previously made pursuant to the “U.S. person” definition in § 23.160(a)(10).

(23) *U.S. swap entity* means a swap entity that is a U.S. person.

(b) *Cross-border application of de minimis registration threshold calculation.* For purposes of determining whether an entity engages in more than a de minimis quantity of swap dealing activity under paragraph (4)(i) of the swap dealer definition in § 1.3 of this chapter, a person shall include the following swaps (subject to paragraph (6) of the swap dealer definition in § 1.3 of this chapter):

(1) If such person is a U.S. person or a significant risk subsidiary, all swaps connected with the dealing activity in which such person engages.

(2) If such person is a non-U.S. person (other than a significant risk subsidiary), all of the following swaps connected with the dealing activity in which such person engages:

(i) Swaps with a counterparty that is a U.S. person, other than swaps conducted through a foreign branch of a registered swap dealer.

(ii) Swaps where the obligations of such person under the swaps are subject to a guarantee by a U.S. person.

(iii) Swaps with a counterparty that is a non-U.S. person where the counterparty's obligations under the swaps are subject to a guarantee by a U.S. person, except when:

(A) The counterparty is registered as a swap dealer; or

(B) The counterparty's swaps are subject to a guarantee by a U.S. person that is a non-financial entity.

(c) *Application of major swap participant tests in the cross-border context.* For purposes of determining a person's status as a major swap participant, as defined in § 1.3 of this chapter, a person shall include the following swap positions:

(1) If such person is a U.S. person or a significant risk subsidiary, all swap positions that are entered into by the person.

(2) If such person is a non-U.S. person (other than a significant risk subsidiary), all of the following swap positions of such person:

(i) Swap positions where the counterparty is a U.S. person, other than swaps conducted through a foreign branch of a registered swap dealer.

(ii) Swap positions where the obligations of such person under the swaps are subject to a guarantee by a U.S. person.

(iii) Swap positions with a counterparty that is a non-U.S. person where the counterparty's obligations under the swaps are subject to a guarantee by a U.S. person, except when the counterparty is registered as a swap dealer.

(d) Notwithstanding any other provision of § 23.23, for purposes of determining whether a non-U.S. person (other than a significant risk subsidiary or a non-U.S. person whose performance under the swap is subject to a guarantee by a U.S. person) engages in more than a de minimis quantity of swap dealing activity under paragraph (4)(i) of the swap dealer definition in § 1.3 of this chapter or for determining the non-U.S. person's status as a major swap participant as defined in § 1.3 of this chapter, such non-U.S. person does not need to count any swaps or swap positions, as applicable, that are entered into by such non-U.S. person on a designated contract market, a registered swap execution facility or a swap execution facility exempted from registration by the Commission pursuant to section 5h(g) of the Act, or a registered foreign board of trade, and cleared through a registered derivatives clearing organization or a clearing organization that has been exempted from registration by the Commission pursuant to section 5b(h) of the Act, where the non-U.S. person does not know the identity of the counterparty to the swap prior to execution.

(e) *Exceptions from certain swap requirements for certain foreign-based swaps*. (1) With respect to its foreign-based swaps, each non-U.S. swap entity and foreign branch of a U.S. swap entity shall be excepted from:

(i) The group B requirements (other than §§ 23.202(a) through 23.202(a)(1)) and the group C requirements with respect to any swap (i) entered into on a designated contract market, a registered swap execution facility or a swap execution facility exempted from registration by the Commission pursuant to section 5h(g) of the Act, or a registered foreign board of trade; (ii) cleared through a registered derivatives clearing organization or a clearing organization that has been exempted from registration by the Commission pursuant to section 5b(h) of the Act; and (iii) where the swap entity does not know the identity of the counterparty to the swap prior to execution; and

(ii) The group C requirements with respect to any swap with a foreign counterparty.

(2) With respect to its foreign-based swaps, each non-U.S. swap entity that is neither a significant risk subsidiary nor a person whose performance under the swap is subject to a guarantee by a U.S. person shall be excepted from the group B requirements with respect to any swap with a foreign counterparty (other than a foreign branch) that is neither a significant risk subsidiary nor a person whose performance under the swap is subject to a guarantee by a U.S. person.

(3) With respect to its foreign-based swaps, each foreign branch of a U.S. swap entity shall be excepted from the group B requirements with respect to any swap with a foreign counterparty (other than a foreign branch) that is neither a significant risk subsidiary nor a person whose performance under the swap is subject to a guarantee by a U.S. person, provided that:

(i) This exception shall not be available with respect to any group B requirement for a swap that is eligible for substituted compliance for such group B requirement pursuant to a comparability determination issued by the Commission prior to the execution of the swap; and

(ii) In any calendar quarter, the aggregate gross notional amount of swaps conducted by a swap entity in reliance on this exception shall not exceed five percent of the aggregate gross notional amount of all its swaps.

(f) *Substituted Compliance*. (1) A non-U.S. swap entity may satisfy any applicable group A requirement by complying with the corresponding requirement of a foreign jurisdiction for which the Commission has issued a comparability determination under paragraph (g) of this section; and

(2) With respect to its foreign-based swaps, a non-U.S. swap entity or foreign branch of a U.S. swap entity may satisfy any applicable group B requirement for a swap with a foreign counterparty by complying with the corresponding requirement of a foreign jurisdiction for which the Commission has issued a comparability determination under paragraph (g) of this section.

(g) *Comparability determinations*. (1) The Commission may issue comparability determinations under this section on its own initiative.

(2) *Eligibility requirements.* The following persons may, either individually or collectively, request a comparability determination with respect to some or all of the group A requirements and group B requirements:

(i) A swap entity that is eligible, in whole or in part, for substituted compliance under this section or a trade association or other similar group on behalf of its members who are such swap entities; or

(ii) A foreign regulatory authority that has direct supervisory authority over one or more swap entities subject to the group A requirements and/or group B requirements and that is responsible for administering the relevant foreign jurisdiction's swap standards.

(3) *Submission requirements.* Persons requesting a comparability determination pursuant to this section shall electronically provide the Commission:

(i) A description of the objectives of the relevant foreign jurisdiction's standards and the products and entities subject to such standards;

(ii) A description of how the relevant foreign jurisdiction's standards address, at minimum, each element of the Commission's corresponding requirements. Such description should identify the specific legal and regulatory provisions that correspond to each element and, if necessary, whether the relevant foreign jurisdiction's standards do not address a particular element;

(iii) A description of the differences between the relevant foreign jurisdiction's standards and the Commission’s corresponding requirements, and an explanation regarding how such differing approaches achieve comparable outcomes;

(iv) A description of the ability of the relevant foreign regulatory authority or authorities to supervise and enforce compliance with the relevant foreign jurisdiction's standards. Such description should discuss the powers of the foreign regulatory authority or authorities to supervise, investigate, and discipline entities for compliance with the standards and the ongoing efforts of the regulatory authority or authorities to detect and deter violations of, and ensure compliance with, the standards;

(v) Copies of the foreign jurisdiction's relevant standards (including an English translation of any foreign language document); and

(vi) Any other information and documentation that the Commission deems appropriate.

(4) *Standard of review.* The Commission may issue a comparability determination pursuant to this section to the extent that it determines that some or all of the relevant foreign jurisdiction's standards are comparable to the Commission's corresponding requirements, after taking into account such factors as the Commission determines are appropriate, which may include:

(i) The scope and objectives of the relevant foreign jurisdiction’s standards;

(ii) Whether the relevant foreign jurisdiction’s standards achieve comparable outcomes to the Commission’s corresponding requirements;

(iii) The ability of the relevant regulatory authority or authorities to supervise and enforce compliance with the relevant foreign jurisdiction's standards; and

(iv) Whether the relevant regulatory authority or authorities has entered into a memorandum of understanding or other arrangement with the Commission addressing information sharing, oversight, examination, and supervision of swap entities relying on such comparability determination.

(5) *Reliance.* Any swap entity that, in accordance with a comparability determination issued under this section, complies with a foreign jurisdiction's standards,

would be deemed to be in compliance with the Commission's corresponding requirements. Accordingly, if a swap entity has failed to comply with the foreign jurisdiction's standards or a comparability determination, the Commission may initiate an action for a violation of the Commission's corresponding requirements. All swap entities, regardless of whether they rely on a comparability determination, remain subject to the Commission's examination and enforcement authority.

(6) *Discretion and Conditions.* The Commission may issue or decline to issue comparability determinations under this section in its sole discretion. In issuing such a comparability determination, the Commission may impose any terms and conditions it deems appropriate.

(7) *Modifications.* The Commission reserves the right to further condition, modify, suspend, terminate or otherwise restrict a comparability determination issued under this section in the Commission's discretion.

(8) *Delegation of authority*. The Commission hereby delegates to the Director of the Division of Swap Dealer and Intermediary Oversight, or such other employee or employees as the Director may designate from time to time, the authority to request information and/or documentation in connection with the Commission's issuance of a comparability determination under this section.

(h) *Records*. Swap dealers and major swap participants shall create a record of their compliance with this section and shall retain records in accordance with § 23.203 of this chapter.

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Issued in Washington, DC, on December 20, 2019, by the Commission.

Robert Sidman,

Deputy Secretary of the Commission.

NOTE: The following appendices will not appear in the Code of Federal Regulations.

Appendices to Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants—Commission Voting Summary and Commissioners' Statements

Appendix 1—Commission Voting Summary

On this matter, Chairman Tarbert and Commissioners Quintenz and Stump voted in the affirmative. Commissioners Behnam and Berkovitz voted in the negative.

Appendix 2—Supporting Statement of Chairman Heath Tarbert

I am pleased to support the Commission's proposed rule on the cross-border application of registration thresholds and certain requirements for swap dealers and major swap participants. It is critical that the CFTC finalize a sensible cross-border registration rule in 2020, as we approach the 10-year anniversary of the Dodd-Frank Act.

Need for Rule-Based Finality

Since 2013, market participants have been relying on cross-border "interpretive guidance,"[1] which was published outside the standard rulemaking process under the

[1] Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45292 (Jul. 26, 2013) ("2013 Guidance"), *http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2013-17958a.pdf*.

Administrative Procedure Act (APA).[2] Although this policy statement has had a sweeping impact on participants in the global swaps market, it is technically not enforceable. Market participants largely follow the 2013 Guidance, but they are not legally required to do so.[3] Over the intervening years, a patchwork of staff advisories and no-action letters has supplemented the 2013 Guidance. With almost seven years of experience, it is high time for the Commission to bring finality to the issues the 2013 Guidance and its progeny address.

We call this a "cross-border" proposal, and in certain respects it is. For example, the proposed rule addresses when non-U.S. persons must count dealing swaps with U.S. persons, including foreign branches of American banks, toward the *de minimis* threshold in our swap dealer definition. More fundamentally, however, the proposed rule answers a basic question: What swap dealing activity *outside* the United States should trigger CFTC registration and other requirements?

Congressional Mandate

To answer this question, we must turn to section 2(i) of the Commodity Exchange Act ("CEA"), a provision Congress added in Title VII of the Dodd-Frank Act.[4] Section 2(i) provides that the CEA does not apply to swaps activities outside the United States except in two circumstances: (1) where activities have a "direct and significant connection with activities in, or effect on, commerce of the United States" or (2) where

[2] 5 U.S.C. 551 *et seq*.
[3] As then Commissioner Scott O'Malia pointed out regarding the 2013 Guidance: "Legally binding regulations that impose new obligations on affected parties—'legislative rules'—must conform to the APA." Appendix 3—Dissenting Statement of Commissioner Scott D. O'Malia, 2013 Guidance at 45372 (citing *Chrysler Corp. v. Brown*, 441 U.S. 281, 302–03 (1979) (agency rulemaking with the force and effect of law must be promulgated pursuant to the procedural requirements of the APA)).
[4] 7 U.S.C. 2(i).

they run afoul of the Commission's rules or regulations that prevent evasion of Title VII.[5] Section 2(i) evidences Congress's clear intent for the U.S. swaps regulatory regime to stop at the water's edge, except where foreign activities either are closely and meaningfully related to U.S. markets or are vehicles to evade our laws and regulations.

I believe the proposed rule before us today is a levelheaded approach to the exterritorial application of our swap dealer registration regime and related requirements. The proposed rule would fully implement the congressional mandate in section 2(i). At the same time, it acknowledges the important role played by the CFTC's domestic and international counterparts in regulating what is a global swaps market. In short, the proposal employs neither a full-throated "intergalactic commerce clause"[6] nor an isolationist mentality. It is thoughtful and balanced.

Guiding Principles for Regulating Foreign Activities

For my part, I am guided by three additional principles in considering the extent to which the CFTC should make full use of its extraterritorial powers.

(1) *Protect the National Interest*

An important role of the CFTC is to protect and advance the interests of the United States. In this instance, Congress provided the CFTC with explicit extraterritorial power

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[5] *Id.*

[6] *See* Commissioner Jill E. Sommers, Statement of Concurrence: (1) Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, Proposed Interpretive Guidance and Policy Statement; (2) Notice of Proposed Exemptive Order and Request for Comment Regarding Compliance with Certain Swap Regulations (June 29, 2012), available at: *https://www.cftc.gov/PressRoom/SpeechesTestimony/sommersstatement062912* (noting that "staff had been guided by what could only be called the 'Intergalactic Commerce Clause' of the United States Constitution, in that every single swap a U.S. person enters into, no matter what the swap or where it was transacted, was stated to have a direct and significant connection with activities in, or effect on, commerce of the United States").

to safeguard the U.S. financial system where swaps activities are concerned. We need to think continually about the potential outcome for American taxpayers. We cannot have a regulatory framework that incentivizes further bailouts of large financial institutions. We therefore need to ensure that risk created outside the United States does not flow back into our country.

But it is not just any risk outside the United States that we must guard against. Congress made that clear in section 2(i). We must not regulate swaps activities in far flung lands simply to prevent every risk that might have a nexus to the United States. That would be a markedly poor use of American taxpayers' dollars. It would also divert the CFTC from channeling our resources where they matter the most: to our own markets and participants. The proposal therefore focuses on instances when material risks from abroad are most likely to come back to the United States and where no one but the CFTC is responsible for those risks.

Hence, guarantees of offshore swaps by U.S. parent companies are counted toward our registration requirements because that risk is effectively underwritten and borne in the United States. The same is true with the concept of a "significant risk subsidiary" (SRS). An SRS is a large non-U.S. subsidiary of a large U.S. company that deals in swaps outside the United States but (1) is not subject to comparable capital and margin requirements in its home country, and (2) is not a subsidiary of a holding company subject to consolidated supervision by an American regulator, namely the Federal Reserve Board. As a consequence, our cross-border rule would require an SRS to register as a swap dealer or major swap participant with the CFTC if the SRS exceeds the same registration thresholds as a U.S. firm operating within the United States. The national interest demands it.[7]

(2) Follow Kant's Categorical Imperative

Rarely does the name of Immanuel Kant, the famous 18th century German philosopher, come up when talking about financial regulation.[8] One of the lasting contributions Kant made to Western thought was his concept of the "categorical imperative." In deducing the laws of ethical behavior, *i.e.*, how people should treat one another, he came up with a simple test: We should act according to the maxim that we wish all other rational people to follow, as if it were a universal law.[9] Kant's categorical imperative is also a good foundation for considering cross-border rulemaking here at the CFTC.

What I take from it is that we should adopt a regulatory regime that we would like all other jurisdictions to follow as if it were a universal law. How does this work? Let me start by explaining how it does not work. If we impose our regulations on non-U.S.

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[7] The SRS concept has been designed to address a potential situation where a U.S. entity establishes an offshore subsidiary to conduct its swap dealing business without an explicit guarantee on the swaps in order to avoid the Dodd-Frank Act. For example, the U.S.-regulated insurance company American International Group ("AIG") nearly failed as a result of risk incurred by the London swap trading operations of its subsidiary AIG Financial Products. *See, e.g.*, Congressional Oversight Panel, June Oversight Report, *The AIG Rescue, Its Impact on Markets, and the Government's Exit Strategy* (June 10, 2010), available at: *http://www.gpo.gov/fdsys/pkg/CPRT–111JPRT56698/pdf/CPRT–111JPRT56698.pdf*. If the Commission did not regulate SRS, an AIG-type entity could establish a non-U.S. affiliate to conduct its swaps dealing business, and, so long as it did not explicitly guarantee the swaps, it would avoid application of the Dodd-Frank Act and bring risk created offshore back into the United States without appropriate regulatory safeguards.

[8] Yet even at first glance, derivatives regulation and Kant's philosophy share some strikingly common attributes. Title 17 of the Code of Federal Regulation (CFR) and *The Critique of Pure Reason* (*Kritik der reinen Vernunft*) (1781) are impenetrable to all but a handful of subject matter experts. And scholars spend decades writing and thinking about them, often coming up with more questions than answers.

[9] "Act only according to that maxim whereby you can, at the same time, will that it should become a universal law." Immanuel Kant, *Grounding for the Metaphysics of Morals* (1785) [1993], translated by James W. Ellington (3rd ed.).

persons whenever they have a remote nexus to the United States, then we should be willing for all other jurisdictions to do the same. The end result would be absurdity, with everyone trying to regulate everyone else. And the duplicative and overlapping regulations would inevitably lead to fragmentation in the global swaps market—itself a potential source of systemic risk.[10] Instead, we should adopt a framework that applies CFTC regulations outside the United States only when it addresses one or more important risks to our country.

Furthermore, we should afford comity to other regulators who have adopted comparable regulations, just as we expect them to do for us. This is especially important when we evaluate whether foreign subsidiaries of U.S. parents could pose a significant risk to our financial system. The categorical imperative leads us to an unavoidable result: We should not impose our regulations on the non-U.S. activities of non-U.S. companies in those jurisdictions that have comparable capital and margin requirements to our own.[11] By the same token, when U.S. subsidiaries of foreign companies operate within our borders, we expect them to follow our laws and regulations and not apply rules from their home country.

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[10] *See* FSB Report on Market Fragmentation (June 4, 2019), available at: *https://www.fsb.org/wp-content/uploads/P040619-2.pdf*.

[11] *See, e.g.,* Comments of the European Commission in respect of CFTC Staff Advisory No. 13-69 regarding the applicability of certain CFTC regulations to the activity in the United States of swap dealers and major swap participants established in jurisdictions other than the United States (Mar. 10, 2014), available at: *https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59781&SearchText=* ("In order to ensure that cross-border activity is not inhibited by the application of inconsistent, conflicting or duplicative rules, regulators must work together to provide for the application of one set of comparable rules, where our rules achieve the same outcomes. Rules should therefore include the possibility to defer to those of the host regulator in most cases.").

Charity, it is often said, begins at home. The categorical imperative further compels us to avoid duplicating the work of other American regulators. If a foreign subsidiary of a U.S. financial institution is subject to consolidated regulation and supervision by the Federal Reserve Board, then we should rely on our domestic counterparts to do their jobs when it is a question of dealing activity outside the United States. The Federal Reserve Board has extensive regulatory and supervisory tools to ensure a financial holding company is prudent in its risk taking at home and abroad.[12] The CFTC does not have similar experience, and therefore should focus on regulating dealing activity within the United States or with U.S. persons.

(3) Pursue SEC Harmonization Where Appropriate

In the jurisdictional fight over swaps, Congress split the baby between the CFTC and the SEC in Title VII of the Dodd-Frank Act.[13] The SEC got jurisdiction over security-based swaps, and we got jurisdiction over all other swaps—the vast majority of the current market.[14] Congress also required both Commissions to consult and coordinate

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[12] For example, the Federal Reserve Board requires all foreign branches and subsidiaries "to ensure that their operations conform to high standards of banking and financial prudence." 12 CFR 211.13(a)(1). Furthermore, they are subject to examinations on compliance. *See* Bank Holding Company Supervision Manual, Section 3550.0.9 ("The procedures involved in examining foreign subsidiaries of domestic bank holding companies are generally the same as those used in examining domestic subsidiaries engaged in similar activities.").

[13] This was unfortunately nothing new. On a number of occasions prior to the Dodd-Frank Act, the CFTC and SEC fought over jurisdiction of certain derivative products. *See, e.g., In Board of Trade of the City Of Chicago v. Securities and Exchange Commission*, 677 F. 2d 1137 (7th Cir. 1982) (finding that the SEC lacked the authority to approve CBOE to trade options on mortgage-backed securities because the options fell within the CFTC's exclusive jurisdiction).

[14] The swaps market is significantly larger than the security-based swaps market. Aggregating across all major asset classes in the global derivatives market, dominated by interest rates and FX, the ratio exceeds 95% swaps to 5% security-based swaps by notional amount outstanding. This ratio holds even with relatively conservative assumptions like assigning all equity swaps (a small asset class) to the security-based swaps category. *See* Bank for International Settlements, OTC derivatives outstanding (Updated 8 December 2019), available at: *https://www.bis.org/statistics/derstats.htm*.

our respective regulatory approaches, and required us to treat economically similar entities or products in a similar manner.[15] Simple enough, right? Wrong.

The CFTC and the SEC could not even agree on a basic concept that is not even particular to financial regulation: who is a "U.S. person." In what can only be described as a bizarre series of events, the CFTC and the SEC adopted different definitions of "U.S. person" in our respective cross-border regimes. I find it surreal that two federal agencies that regulate similar products pursuant to the same title of the same statute—with an explicit mandate to "consult and coordinate" with each other—have not agreed until today on how to define "U.S. person." This failure to coordinate has increased operational and compliance costs for market participants.[16] And that is why I am pleased that our proposal uses the same definition of U.S. person that is in the SEC's cross-border rulemaking.

To be sure, as my colleagues have said on several occasions, we should not harmonize with the SEC merely for the sake of harmonization.[17] I agree that we should harmonize only if it is sensible. In the first instance, we must determine whether Congress has explicitly asked us to do something different or implicitly did so by giving us a different statutory mandate. It also requires us to consider whether differences in our

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[15] *See* Section 712(a)(7) of the Dodd-Frank Act.

[16] *See, e.g.*, Futures Industry Association Letter re: Harmonization of SEC and CFTC Regulatory Frameworks (Nov. 29, 2018), available at: *https://fia.org/articles/fia-offers-recommendations-cftc-and-sec-harmonization*.

[17] *See, e.g.*, Dissenting Statement of Commissioner Dan M. Berkovitz, Rulemaking to Provide Exemptive Relief for Family Office CPOs: Customer Protection Should be More Important than Relief for Billionaires (Nov. 25, 2019), available at: *https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement112519* ("The Commission eliminates the notice requirement largely on the basis that this will harmonize the Commission's regulations with those of the SEC. Harmonization for harmonization's sake is not a rational basis for agency action.").

respective products or markets warrant a divergent approach. Just as the proposed rule takes steps toward harmonization, it also diverges where appropriate.

The prime example is the approach we have taken with respect to "ANE Transactions."[18] ANE Transactions are swap (or security-based swap) transactions between two non-U.S. persons that are "arranged, negotiated, or executed" by their personnel or agents located in the United States, but booked to entities outside America. While some or all of the front-end sales activity takes place in the United States, the financial risk of the transactions resides overseas.

Here, key differences in the markets for swaps and security-based swaps are dispositive. The swaps market is far more global than the security-based swaps market is. While commodities such as gold and oil are traded throughout the world, equity and debt securities trade predominantly in the jurisdictions where they were issued. For this reason, security-based swaps are inextricably tied to the underlying security, and vice versa. This is particularly the case with a single-name credit default swap. The arranging, negotiating, or execution of this kind of security-based swap is typically done in the United States because the underlying reference entity is a U.S. company. Because security-based swaps can affect the price and liquidity of the underlying security, the SEC has a legitimate interest in requiring these transactions to be reported. By contrast,

[18] *See* SEC, Proposed Rule Amendments and Guidance Addressing Cross-Border Application of Certain Security-Based Swap Requirements, 84 Fed. Reg. 24206 (May 24, 2019), available at: *https://www.govinfo.gov/content/pkg/FR-2019-05-24/pdf/2019-10016.pdf*.

because commodities are traded throughout the world, there is less need for the CFTC to apply its swaps rules to ANE Transactions.[19]

In addition, as noted above, Congress directed the CFTC to regulate foreign swaps activities outside the United States that have a “direct and significant” connection to our financial system. Congress did not give a similar mandate to the SEC. As a result of its different mandate, the SEC has not crafted its cross-border rule to extend to an SRS engaged in swap dealing activity offshore that may pose a systemic risk to our financial system. Our proposed rule does, aiming to protect American taxpayers from another Enron conducting its swaps activities through a major foreign subsidiary.[20]

Conclusion

In sum, the proposed rule before us today represents a critical step toward finalizing the regulations Congress asked of us nearly a decade ago. I believe our proposal is also a sensible and principled approach to addressing when foreign transactions should fall within the CFTC’s swaps registration and related requirements.

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[19] Under the proposal, persons engaging in any aspect of swap transactions within the United States remain subject to the CEA and Commission regulations prohibiting the employment, or attempted employment, of manipulative, fraudulent, or deceptive devices, such as section 6(c)(1) of the CEA (7 U.S.C. 9(1)) and Commission regulation 180.1 (17 CFR 180.1). The Commission thus would retain anti-fraud and anti-manipulation authority, and would continue to monitor the trading practices of non-U.S. persons that occur within the territory of the United States in order to enforce a high standard of customer protection and market integrity. Even where a swap is entered into by two non-U.S. persons, we have a significant interest in deterring fraudulent or manipulative conduct occurring within our borders, and we cannot let our country be a haven for such activity.

[20] The SEC’s cross-border rule would, however, appear to extend to a foreign-to-foreign transaction *not* involving the arranging, negotiation, or execution of the trade in the United States if the transaction involved an SEC-registered broker-dealer.

Perhaps President Eisenhower said it best: "The world must learn to work together, or finally it will not work at all."[21] My sincere hope is that our domestic and international counterparts will view this proposal as a concrete step toward working together to provide sound regulation to the global swaps market.

[21] Transcript of President Dwight D. Eisenhower's Farewell Address (1961), available at: *https://www.ourdocuments.gov/doc.php?flash=true&doc=90&page=transcript*.

Appendix 3—Supporting Statement of Commissioner Brian Quintenz

I am very pleased to support today's proposed rule, which, in my view, delineates important boundaries of the Commission's regulation of swaps activity conducted abroad, which would codify elements of the Commission's 2013 interpretive guidance,[1] and make important adjustments with the benefit of six years' additional experience in swaps market oversight.

<u>Direct AND Significant</u>

As I have said before, the foundational principle underlying any CFTC regulation of cross-border swaps activity, and the prism through which all extraterritorial reach by the CFTC must be viewed, is the statutory directive from Congress that the agency may only regulate those activities outside the United States that "have a direct and significant connection with activities in, or effect on commerce of, the United States."[2] Congress deliberately placed a clear and strong limitation on the CFTC's extraterritorial reach, recognizing the need for international comity and deference in a global swaps market.

I believe the proposal strikes a strong balance in interpreting Section 2(i) of the CEA. The proposal before us would interpret this provision in ways that both provide important safeguards to the U.S. financial markets, and avoid duplicative regulation or disadvantaging U.S. commercial and financial institutions acting in foreign markets.

<u>Registration</u>

[1] Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45,292 (July 26, 2013).
[2] Sec. 2(i) of the Commodity Exchange Act (CEA).

The proposal would require a foreign institution dealing in swaps to count the notional value of the swaps it executes towards the CFTC's recently finalized $8 billion registration threshold[3] only in certain, enumerated circumstances that clearly concern U.S. institutions and implicate risk to the U.S. financial system when that risk is not otherwise addressed by the Commission or by the banking regulators.[4] I would like to highlight a few of these circumstances.

First, a foreign swap dealing firm would generally be required to count swaps executed opposite a "*U.S. person*."[5] I believe the proposed definition of *U.S. person*[6] is an improvement upon the one included in the 2013 guidance.[7] The proposed definition of *U.S. person* is also consistent with the one published by the SEC in connection with that agency's oversight over security-based SDs and MSPs.[8] Only in Washington could two financial regulators have different definitions of a *U.S. Person*. Such a harmonized definition, if finalized, will facilitate compliance with the CFTC's and SEC's swaps regulations by dually registered entities. The proposed definition is largely similar to the definition of *U.S. person* issued by the Commission in 2016 in connection with the rule for cross-border applicability of the margin requirements for uncleared swaps,[9] and more streamlined than the one included with the Commission's 2013 cross-border guidance,

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[3] CFTC regulation 1.3 (definition of *swap dealer*, paragraph (4)), promulgated by De Minimis Exception to the SD Definition, 83 Fed. Reg. 56,666 (Nov. 13, 2018) (final rule).
[4] Proposed CFTC regulation 23.23(b).
[5] Proposed 23.23(b)(1).
[6] Proposed 23.23(a)(22).
[7] Interpretive Guidance, 45,316-317.
[8] Securities and Exchange Act rule 3a71-3(a)(3)(ii) & (4)(iv), promulgated by Application of "Security-Based Swap Dealer" and "Major Security-Based Swap Participant" Definitions to Cross-Border Security-Based Swap Activities, 79 Fed. Reg. 47,278, 47,313 (Aug. 12, 2014).
[9] CFTC regulation 23.160(a)(10), promulgated by Margin Requirements for Uncleared Swaps for SDs and MSPs – Cross-Border Application of the Margin Requirements, 81 Fed. Reg. 34,818 (May 31, 2016).

for example in the context of investment funds. This will make it easier for market participants readily to determine their status. One element of the definition that I would like to highlight, an element that is consistent with the SEC's rule, is that an investment fund would be considered a *U.S. person* if the fund's primary manager is located in the U.S.[10] (proposed 23.23(a)(22)(ii)).

In addition to counting swaps opposite a *U.S. person*, a foreign firm would also be required to count swaps executed opposite a non-U.S. entity, if that firm's obligations under the swap are "*guaranteed*" by a *U.S. person*, or if the counterparty's obligations are U.S.- *guaranteed*.[11] Here too, the proposal provides a simpler, more targeted definition of *guarantee*[12] than the one published in the 2013 guidance,[13] and the definition is consistent with the one included in the Commission's cross-border rule for uncleared swap margining.[14] The definition would include an arrangement under which a party to a swap has rights of recourse against a guarantor, including traditional guarantees of payment or performance, but it would not include other financial arrangements or structures such as "keepwells and liquidity puts" or master trust agreements.

Notably, if a non-U.S. firm's obligations to a swap are *guaranteed* by a non-financial U.S. entity (meaning a U.S. commercial end-user), then that swap would be excluded from the foreign dealer's tally towards possible CFTC registration.[15] Commercial end-users typically enter into swaps for hedging purposes, and their swaps

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[10] Proposed 23.23(a)(22)(ii).
[11] Proposed 23.23(b)(2)(ii) and (iii).
[12] Proposed 23.23(a)(8).
[13] Interpretive Guidance, 45,318-20.
[14] 23.160(a)(2).
[15] Proposed 23.23(b)(2)(iii)(*2*).

generally pose less risk to the financial system than swaps by financial institutions. The fact that a foreign dealer would not be required to count a swap with a U.S.-*guaranteed* commercial end-user towards the dealer's possible CFTC registration may give foreign subsidiaries of U.S. commercial firms a greater choice of swap dealers. This flexibility is consistent with Congress' decision not to apply to commercial end-users either the requirement that certain swaps be cleared at a derivatives clearing organization (DCO) ("*swap clearing requirement*") or that uncleared swaps be subject to margin requirements.[16]

I would also like to highlight that the proposal properly does not require a foreign dealer to count towards the CFTC's registration threshold a swap opposite a foreign branch of a U.S. institution already registered with the CFTC as an SD.[17] While a U.S. SD of course stands behind a swap executed by its foreign branch, I believe it makes sense for the Commission not to require a foreign dealer to count that swap towards the foreign dealer's tally for possible CFTC registration because the CFTC is already overseeing the U.S. firm, and its swaps, due to the U.S. firm's SD registration.

FCS – Not "Significant" on Accounting Consolidation Alone

Today's proposal makes an important, and appropriate, distinction from the Commission's 2016 proposal on the cross-border application of the SD registration threshold and SD business conduct standards.[18] That proposal would have required

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[16] Secs. 2(h)(1) and 4s(e) of the CEA, implemented by parts 50 and 23 subpart E of the Commission's regulations.
[17] Proposed 23.23(b)(2)(i).
[18] Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to SDs and MSPs, 81 Fed. Reg. 71,946 (Oct. 18, 2016) (proposed rule).

thousands of non-U.S. firms to count all of their dealing swaps, with U.S. and non-U.S. counterparties alike, towards possible CFTC SD registration. For instance, the 2016 proposed rule would have required every foreign subsidiary of a U.S. firm that, for accounting purposes, consolidates its financial statements into its parent, (referred to as a "*foreign consolidated subsidiary*") to count all of its swaps.[19] While an accounting link between a foreign subsidiary and its U.S. parent may have satisfied the "direct" connection to U.S. activities under CEA 2(i), an accounting link alone is meaningless in terms of the 2(i) "significant" connection to commerce of the U.S.

By contrast, today's proposal creates a sensible "significance" test for a foreign subsidiary of a U.S. firm through the classification of a "*significant risk subsidiary*," which would be required to count every dealing swap towards possible CFTC SD registration.[20] The proposed *significant risk subsidiary* class targets only a foreign entity that may present major risk to a large U.S. institution and appropriately scopes out the limits of Section 2(i) of the CEA.[21] Moreover, a *significant risk subsidiary* does not include an entity already subject to supervision either by the Federal Reserve Board or by a foreign banking regulator operating under Basel standards in a jurisdiction that the Commission determined has instituted a margining regime for uncleared swaps that is

[19] 2016 proposed regulations 1.3(ggg)(7) and 1.3(aaaaa).
[20] Proposed 23.23(a)(12) and 23.23(b)(1).
[21] In order to be a *significant risk subsidiary*, the U.S. parent must have at least $50 billion in global consolidated assets, and the subsidiary must exceed one of three thresholds (measured according to a percentage of capital, revenue, or assets) as compared to its parent (proposed 23.23(a)(12)-(13)). The proposed definition of "*significant subsidiary*" is consistent with the definition of this term included in SEC Regulation S-X (17 CFR 210.1-01(w)).

comparable to the Commission's framework for margining uncleared swaps.[22] This construct makes sense. The Federal Reserve already reviews swaps activity by foreign subsidiaries of bank holding companies.[23] Additionally, the CFTC has already found multiple jurisdictions' uncleared margin regimes comparable to ours. In order to eliminate duplicative regulation, and for the sake of international comity and respect for foreign jurisdictions' sovereignty, it is prudent for the Commission to rely on other authorities, either the Federal Reserve or its counterparts in comparable jurisdictions, to supervise the swaps entered into by non-U.S. subsidiaries of the banks they supervise on a consolidated basis.

By limiting the number of foreign firms registered with the CFTC as SDs, I believe the Commission, together with the National Futures Association (NFA), will best apply the agency's limited resources to the non-U.S. entities outside of the Federal Reserve's purview, especially given that there are already over 100 registered SDs organized in more than 10 countries.[24]

Business Conduct Requirements

In addition to setting boundaries in the area of non-U.S. firms counting swaps towards possible CFTC registration, today's proposal would build on the 2013 guidance by providing certainty regarding when a non-U.S. firm, which is registered with the

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[22] Proposed 23.23(a)(12)(i)-(ii). To date, the Commission has determined Australia, the E.U., and Japan to have issued margining regimes for uncleared swaps comparable to the Commission's (82 Fed. Reg. 48,394 (Oct. 18, 2017 (E.U.); 84 Fed. Reg. 12,908 (Apr. 3, 2019) (Australia); and 84 Fed. Reg. 12,074 (Apr. 1, 2019) (Japan)).

[23] Federal Reserve Board, Bank Holding Co. Supervision Manual, sec. 2100.0.1 Foreign Operations of U.S. Banking Organizations, available at, *https://www.federalreserve.gov/publications/files/bhc.pdf*.

[24] List of SDs available on the CFTC's website at, *https://www.cftc.gov/LawRegulation/DoddFrankAct/registerswapdealer.html*.

CFTC as an SD, must comply with the Commission's SD standards. Again, importantly and appropriately out of respect for foreign jurisdictions, the proposal would exempt swaps executed with certain counterparties located abroad and make available compliance with local rules that the CFTC has determined comparable to its own ("substituted compliance").[25] The proposed rule also sets forth exemptions and substituted compliance for foreign branches of U.S. financial institutions registered as SDs with the CFTC.[26] As in 2013, the Commission believes that certain of the Commission's SD rules, or comparable foreign rules, should apply to every registered SD, including one organized in a foreign jurisdiction, with respect to all of the dealer's swaps, namely requirements concerning: a *Chief Compliance Officer*; a *risk management program*, including *special rules for when the SD is a member of a DCO*; *addressing conflicts of interest* and *antitrust considerations*; *recordkeeping*; *disclosing information to the CFTC and banking regulators*; and *position limits monitoring* (collectively, the "Group A requirements").[27] I note that substituted compliance is currently available for particular Group A requirements for SDs established in, and operating out of, Australia, Canada, the E.U., Hong Kong, Japan, and Switzerland.[28]

With regard to other SD requirements, namely *daily trading records*, *confirmations*, *documentation*, and *portfolio reconciliation and compression*

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[25] Proposed 23.23(e)-(f).
[26] *Id.*
[27] CFTC regulations 3.3, 23.201, 23.203, 23.600-607, and 23.609 (referred to by the Proposal as the "Group A requirements" (proposed 23.23(a)(5) and 23.23(e)-(f)). "Entity-level" comparability determinations, available at, *https://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/index.htm*.
[28] "Entity-level" comparability determinations, available at, *https://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/index.htm*.

(collectively, the "Group B requirements"),[29] today's proposal reasonably exempts foreign firms registered with the Commission as SDs, as well as foreign branches of U.S. registered as SDs, from these requirements for swaps with certain counterparties located outside of the U.S., including those non-U.S. counterparties whose swap obligations are not *guaranteed* by a *U.S. person* and those foreign counterparties not covered by the proposed definition of *significant risk subsidiary*.[30] As with the 2013 guidance, substituted compliance is also available.[31] Finally, under today's proposal, both a non-U.S. firm registered with the Commission as an SD, and the foreign branch of a U.S. firm registered as an SD, would only be required to comply with a set of business conduct requirements, those addressing how registered SDs transact with certain counterparties (collectively, the "Group C requirements"),[32] for swaps with U.S. counterparties, but not with non-U.S. counterparties.[33]

"ANE" - Eliminating the "Elevator Test"

Today's proposal makes an important distinction from how the Commission's Division of Swap Dealer and Intermediary Oversight (DSIO) addressed compliance with "transaction-level requirements" (referred to in today's proposal as Groups B and C requirements) in 2013. A November 2013 DSIO Advisory[34] suggested that a foreign

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[29] CFTC regulations 23.202 and 501-504 (referred to by the Proposal as the "Group B requirements (proposed 23.23(a)(6)).
[30] Proposed 23.23(e)(2).
[31] Proposed 23.23(f)(2). Currently, substituted compliance for certain Group B requirements is available for SDs organized in the E.U. and in Japan. These comparability determinations are available at, *https://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/index.htm*.
[32] CFTC regulations 23.400-451 (referred to by the proposal as the Group C requirements (proposed 23.23.(a)(7)).
[33] Proposed 23.23(e)(1)(ii).
[34] CFTC Staff Advisory 13-69 (Nov. 14, 2013).

CFTC-registered SD must comply with CFTC transaction-level requirements even in connection with a swap opposite another non-U.S. person if the SD used personnel located in the U.S. to "*arrange," "negotiate"* or *"execute"* (ANE) the swap. Such a broad, vague, and burdensome application caused such widespread confusion and international condemnation that it was, within 13 days of publishing, placed under no-action relief.[35] That no-action relief exists to this day, having been renewed six times.[36]

Prudently, today's proposal eliminates the ANE standard. I believe the Commission should only consider applying its transaction-level requirements to a foreign registered SD when a swap is executed opposite a U.S. counterparty.[37] The fact that the foreign SD may be using U.S. personnel to support the transaction does not implicate how the swap should be executed with a foreign counterparty. Under the limited extra-territorial jurisdiction Congress gave to the CFTC in overseeing the swaps market, it is appropriate that the Commission refrains from requiring foreign firms to comply with the CFTC's SD transaction-level requirements, or comparable foreign requirements, for swaps where both counterparties are outside of the United States and there is no U.S. nexus.

Enhancing Substituted Compliance

I am pleased that today's proposal codifies a process under which the Commission will issue future substituted compliance determinations.[38] Substituted

[35] CFTC Letter 13-71 (Nov. 26, 2013).
[36] CFTC Letters 14-01, 14-74, 14-140, 15-48, 16-64, and 17-36.
[37] I note that the proposal also appropriately applies the Group B requirements to a swap involving a non-U.S. person that is either U.S.-*guaranteed* or a *significant risk subsidiary* (proposed 23.23.(e)(2)).
[38] Proposed 23.23(f).

compliance is the lynchpin of a global swaps market. Said differently, the absence of regulatory deference has been the fracturing sound we hear as the global swaps market fragments. The 11 substituted compliance determinations the Commission has issued to date for registered SDs, concerning business conduct and uncleared swap margining rules, highlight the progress other jurisdictions have made in issuing swaps rules. While not identical, those rulesets largely address the same topics and guard against the same risks. I hope that the Commission will soon be in a position to issue additional comparability determinations, particularly for Group B requirements. Whereas Group A substituted compliance determinations have been issued for six jurisdictions (Australia, Canada, the E.U., Hong Kong, Japan, and Switzerland), Group B substituted compliance determinations have been issued for only two jurisdictions (the E.U. and Japan).

In conclusion, I am pleased that the Commission is making meaningful progress in providing legal certainty to the market with regard to complying with the Dodd-Frank swaps regulations on a cross-border basis. I hope that the Commission will soon propose other cross-border regulations regarding other areas of the CFTC's swap regulations, including the swap clearing requirement, the trade execution requirement,[39] and the swaps reporting requirement.[40]

I would like to thank the staff of DSIO for their efforts on this proposal, as well as a personal thank you to Matt Daigler from the Chairman's office, who worked tirelessly on this proposal and its unpublished predecessor and has held countless conversations with me and my staff on this issue over the past year.

[39] Sec. 2(h)(8) of the CEA, implemented by CFTC part 37.
[40] Secs. 2(a)(13) and 21 of the CEA, implemented by CFTC parts 43 and 45.

Appendix 4—Dissenting Statement of Commissioner Rostin Behnam

Introduction

I respectfully dissent from the Commodity Futures Trading Commission's (the "Commission" or "CFTC") notice of proposed rulemaking addressing the cross-border application of the registration thresholds and certain requirements applicable to swap dealers ("SDs") and major swap participants ("MSPs") (the "Proposal"). I support the Commission's effort to make good on its commitment to periodically review its approach to evaluating the circumstances under which the swaps provisions of Title VII of the Dodd-Frank Act[1] ought to apply to swap dealing and related activities outside the United States.[2] Indeed, the Guidance currently in place and Section 2(i) of the Commodity Exchange Act (the "Act" or "CEA") itself provide the Commission the flexibility to evaluate its approach on a case-by-case basis, affording interested and affected parties the opportunity to present facts and circumstances that would inform the Commission's application of the relevant substantive Title VII provisions in each circumstance.[3] Today, the Commission, without adequate explanation of its action, consideration of alternatives, or deference to the wisdom of the United States District Court for the District of Columbia on the matter, is proposing to discard both the existing Guidance and the use of agency guidance and non-binding policy statements altogether in addressing the cross-border reach of its authority in favor of hard and fast rules. I simply do not believe the

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[1] The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203 section 712(d), 124 Stat. 1376, 1644 (2010) (the "Dodd-Frank Act").
[2] *See* Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swaps Regulations, 78 FR 45292, 45297 (Jul. 26, 2013) (the "Guidance").
[3] *Id.*

Commission has made a strong enough case for wholesale abandonment of guidance at this point in the evolution of our global swaps markets, and in light of current events that are already impacting market participants and their view of the future global swaps landscape. As well, I have serious questions and concerns as to what the Commission may give up should the Proposal be codified in its current form.

Whereas the Commission understands the scope of our jurisdictional reach with respect to Title VII, a federal district court has affirmed that understanding, and we have operated within such boundaries—aware of the risks and successfully responding in kind, the Commission is now making a decision based on the most current thinking that we should retreat under a banner of comity and focus only on that which can fit on the head of a pin. Oddly enough, that pin will hold only the giants of the swaps market. Indeed, where our jurisdiction stands on its own, the ability to exercise our authority through adjudication[4] and enforcement has allowed the Commission to articulate policy fluidly, refining our approach as circumstances change without the risk of running afoul of our mandate. Today's Proposal suggests that we can resolve all complexities in one fell swoop if we alter our lens, abandon our longstanding and literal interpretation of CEA section 2(i), and limit ourselves to a purely *risk-based approach*. I cannot support an approach that would limit our jurisdiction and consequently oversight directly in conflict with Congressional intent, and potentially expose the U.S. to systemic risk.

Throughout the preamble, the Proposal evinces a clear understanding that the complexity of swaps markets, transactions, corporate structures and market participants

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[4] *See* 5 U.S.C. 554.

create channels through which swaps-related risks warrant our attention by meeting the jurisdictional nexus described in CEA Section 2(i).[5] However, in many instances, we manage to simply acknowledge the obvious risk and step aside in favor of the easier solution of doing nothing, assuming that the U.S. prudential regulators will act on our behalf, or waving the comity banner. The Proposal provides shorthand rationales for each of its decision points without the support of data or direct experience as if doing so would reveal the vision's vulnerabilities. Perhaps most concerning are the Proposal's contracted definitions of "U.S. person" and "guarantee," its introduction of "substantial risk subsidiaries," and its determination that "ANE" means something akin to "absolutely nothing to explain" regarding our jurisdictional interest—even when activities are occurring within the territorial United States. These represent some notable examples where the Proposal undermines the core protections sought to be addressed by section 2(i), as the Commission has, until now, understood them to be.

My concerns aside for a moment, I am grateful that within the four corners of the document, the requests for comment seek to build consensus and operatively provide the public an option to maintain the status quo with regard to most aspects of the Guidance—albeit without sticking with guidance. While this leads me to more questions as to whether and how the Proposal could go final absent additional intervening process, I am pleased that there is recognition that the public and market participants may have lost their appetite for this brand of rulemaking or perhaps have come to agree with the D.C. District Court that the Commission's decision to issue the Guidance benefits market

[5] *See, e.g.,* Proposal at I.B., I.C., II.B, II.C., V, and VII.

participants.[6] Further, as the Commission currently engages with our foreign counterparts regarding impending regulatory matters related to Brexit, I hope we are measured in timing and substance on the Proposal.

Before I highlight certain aspects of the Proposal, I want to take a brief moment to acknowledge why—as a general matter—we are here, and why this particular proposal is so important. Without rehashing market realties that led to the economic devastation of 2008, it should never be lost on our collective consciousness that a significant driving force that exacerbated the financial crisis and great recession, at least within the context of the over-the-counter derivatives market, was housed overseas. Although much of the risk completed its journey within the continental U.S., it was conjured up in foreign jurisdictions.[7] But, as we all also know too well, more than 10 years later, despite the products often being constructed, sold, and traded overseas, the highly complex web of relationships between holding companies, subsidiaries, affiliates, and the like, created a perfect storm that brought our financial markets to a near halt, and the global economy to a shudder. Those experiences should always serve as the foundation from which we craft cross-border derivatives policy. Always.

Cutting to the Chase on Codification

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[6] *See SIFMA v. CFTC*, 67 F.Supp.3d 373, 426-427, 429 (D.D.C. 2014) (finding the CFTC's choice to address extraterritorial application of the Title VII Rules incrementally and through the Guidance reasonable, "particularly, where, as here, 'the agency may not have had sufficient experience with a particular problem to warrant rigidifying its tentative judgment into a hard and fast rule' and 'the problem may be so specialized and varying in nature as to be impossible to capture within the boundaries of a general rule.'" (quoting *SEC v. Chenery Corp*., 332 U.S. 194, 202-203, 67 S.Ct. 1760, 90 L.Ed 1995(1947))).

[7] *See* Guidance, 78 FR at 45293-5; *SIFMA v. CFTC*, 67 F.Supp.3d at 387-88 (describing the "several poster children for the 2008 financial crisis" that demonstrate the impact that overseas over-the-counter derivatives swaps trading can have on a U.S. parent corporation).

Since 2013, when the Commission announced its first cross-border approach in flexible guidance as a non-binding policy statement,[8] the Commission has understood that addressing the complex and dynamic nature of the global swaps market cannot be described in black and white, and that even describing it in shades of gray quickly overwhelms our regulatory sensibilities. Cutting through the haze with bright line rules for identity, ownership, control, and attribution to find comfort in comity seems to be our approach in addressing the nature of risk in the global swaps market. However, Congress has granted the Commission authority without any attendant instruction to engage in rulemaking.[9] Under such circumstances, the Commission must critically evaluate whether a rule-driven application of policy amid a global market that is only growing in size and in its complexity may prove inadequate as we carry out our mandate and protect our domestic interests. It seems in this instance that the Commission is barreling toward hard and fast comprehensive rules without acknowledging the benefits of what we have today.

To be clear, while I support the Commission's efforts to address problems resulting from its current approach to regulating swaps activities in the cross-border context, it is not clear to me at this moment that we have reached a point where codification would provide immediate benefits to either the Commission or the public. While the Guidance is complex, it is difficult to say it is any more complex than the

[8] *See* Guidance, 78 FR at 45292.
[9] *SIFMA v. CFTC*, 67 F.Supp.3d at 423-25, 427 (finding that Section 2(i) operates independently and provides the CFTC with the authority—without implementing regulations—to enforce the Title VII Rules extraterritorially); *See also, Id. at* 427 ("Although many provisions in the Dodd-Frank Act explicitly require implementing regulations, Section 2(i) does not.").

Proposal. The complexity is and will be inherent to whatever action we take as it, "merely reflects the complexity of swaps markets, swaps transactions, and the corporate structures of the market participants that the CFTC regulates."[10] It is this type of complexity that supported the Commission's initial determination to issue the Guidance, and to my knowledge, such determination has not hindered the Commission's ability to pursue enforcement actions that apply Title VII extraterritorially[11] or to participate in discourse with and decision-making among our fellow international financial regulators.

CEA Section 2(i) Preservation

As recognized by the D.C. District Court, the Title VII statutory and regulatory requirements apply extraterritorially through the independent operation of CEA section 2(i), which the CFTC is charged with enforcing.[12] Congress did not direct—and has not since directed—the Commission to issue rules or even guidance regarding its intended enforcement policies pursuant to CEA section 2(i). To the extent the CFTC interpreted Section 2(i) in the Guidance, an interpretation carried forward in the Proposal, such interpretation is drawn linguistically from the statute; its interpretation has not substantively changed the regulatory reach.[13] Putting aside the anti-evasion prong in CEA section 2(i)(2), it remains that the Commission construes CEA section 2(i) to apply the swaps provisions of the CEA to activities, viewed in the class or aggregate, outside

[10] *Id.* at 419-20 ("Indeed, the complexity of a regulatory issue is one reason an agency might choose to issue a non-binding policy statement rather than a rigid 'hard and fast rule.'" (citing *SEC v. Chenery Corp*., 332 U.S. 194, 202-203, 67 S.Ct. 1760, 90 L.Ed 1995(1947))).
[11] *See, e.g., SIFMA v. CFTC*, 67 F.Supp.3d at 421, ("Indeed, even after promulgating the Cross-Border Action, the CFTC has relied *solely* on its statutory authority in Section 2(i) when bringing enforcement actions that apply to Title VII Rules extraterritorially.").
[12] *SIFMA v. CFTC, supra* note 9.
[13] *SIFMA v. CFTC*, 67 F.Supp.3d at 424.

the United States that, meet either of two jurisdictional nexus: (1) a direct and significant effect on U.S. commerce; or (2) a direct and significant connection with activities in U.S. commerce, and through such connection, present the type of risks to the U.S. financial system and markets that Title VII directed the Commission to address.[14] Accordingly, to any extent the Commission is moving away from guidance towards substantive rulemaking, it must preserve that interpretation.

As I read the Proposal—which purports to reflect the Commission's current views[15]—I cannot help but notice that our "risk-based approach" seems to focus on individual entities that present a particular category of significant risk--the giants among global swap market participants-- and ignores smaller pockets of risk that, in the aggregate, may ultimately raise systemic risk concerns.[16] What is lacking is any discussion of how our laser focus on individual corporate families and their ability to singularly impact systemic risk to the U.S. financial system adequately ensures that we are not disregarding the potential for similar swap dealing activities of groups of market participants, regardless of individual size, and in the aggregate, present a similar risk profile, or at the least a risk profile worth monitoring. Perhaps more troubling, the Proposal is focused largely on the threshold matter of swap dealer registration requirements. However, as the Commission has acknowledged, "Neither the statutory definition of 'swap dealer' nor the Commission's further definition of that term turns

[14] *See* Proposal at C.1.; Guidance, 78 FR at 45292, 45300; see also *SIFMA v. CFTC*, 67 F.Supp.3d at 424-5.
[15] Proposal at I.A.
[16] The Commission proposes to limit its supervisory oversight outside the United States, "*only* as necessary to address risk to the resiliency and integrity of the U.S. financial system." Proposal at I.D. (emphasis supplied).

solely on risk to the U.S. financial system."[17] And to that end, "[T]he Commission does not believe that the location of counterparty credit risk associated with a dealing swap—which…is easily and often frequently moved across the globe—should be determinative of whether a person's dealing activity falls within the scope of the Dodd-Frank Act."[18]

I also cannot help but notice the Proposal seems to frequently reference "comity" without providing supporting rationales for deferring to our fellow domestic regulators and foreign counterparts or for providing per se exemptions. I support working closely with foreign regulators to address potential conflicts with respect to each of our respective regulatory regimes, and I believe that our cross-border approach must absolutely align with principles of international comity. But, I do not understand how we can reach regulatory absolutes and conclusions based on comity, absent a finding that the exercise of our authority under CEA section 2(i) would be patently unreasonable under international principles. I believe that substituted compliance is generally the most workable and respectful solution, and I believe we must engage with our fellow global regulators to address matters of risk that may impact each of our jurisdictions regardless of size and nature.

Contraction Justifies Inaction—"U.S. Persons" and "Guarantees"

The bulk of the Proposal is dedicated to codifying 23 definitions "key" to determining whether certain swaps or swap positions would need to be counted towards a person's SD or MSP threshold and in addressing the cross-border application of the Title

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[17] Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants, 81 FR 71946, 71952 (Oct. 18, 2016) ("2016 Proposal").

[18] *Id.*

VII requirements. While most of the defined terms are familiar from the Guidance, there are some differences that stand out as more than a simple exercise in conformity. For example, the preamble of the Proposal describes the proposed definition of "U.S. person" as "largely consistent with" and the definition of "guarantee" as "consistent with" the Commission's Cross-Border Margin Rule.[19] However, both represent a narrowing in scope from the current Guidance, and in turn, may potentially retract our authority under CEA Section 2(i) with respect to swap dealing activities relevant to swap dealer registration and oversight.

With regard to "U.S. persons," the definition harmonizes with the definition adopted by the Securities and Exchange Commission ("SEC") in the context of its regulations regarding cross-border security-based swap activities, which largely encompasses the same universe of persons as the Commission's Cross-Border Margin Rule. However, among other things, the proposed "U.S. person" definition, unlike the Cross Border Margin Rule, would not include certain legal entities that are owned by one or more U.S. person(s) and for which such person(s) bear unlimited responsibility for the obligations and liabilities of the legal entity ("unlimited U.S. responsibility prong").[20] In support of its decision, the Commission puts forth what almost reads as an incomplete syllogism that fatally fails to address how such relationships may satisfy the jurisdictional nexus laid out in CEA section 2(i). After noting (1) that the SEC does not include an unlimited U.S. responsibility prong because it considers this type of arrangement as a

[19] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Cross-Border Application of the Margin Requirements, 81 FR 34818 (May 31, 2016).
[20] Proposal at II.A

guarantee, and (2) that when considering the issue in the context of the Cross-Border Margin rule, the Commission does not view the unlimited U.S. responsibility prong as equivalent to a U.S. guarantee, the Proposal states that (3) the Commission is not revisiting its interpretation of "guarantee" and is not including an unlimited U.S. responsibility prong in the "U.S. person" definition because it "is of the view that the corporate structure that this prong is designed to capture is not one that is commonly used in the marketplace."[21]

To be clear, the Guidance includes an unlimited U.S. responsibility prong in its interpretation of "U.S. persons" for purposes of applying CEA section 2(i) that is intended to cover entities that are directly or indirectly owned by U.S. person(s) such that the U.S. owner(s) are ultimately liable for the entity's obligations and liabilities.[22] Among other things, where this relationship exists, the Commission's stated view is that, "[W]here the structure of an entity is such that the U.S. owners are ultimately liable for the entity's obligations and liabilities, the connection to activities in, or effect on, U.S. Commerce would generally satisfy section 2(i)..."[23]

While I am not arguing that the Commission cannot change its views regarding the necessity for including a U.S. responsibility prong in a proposed "U.S. person" definition, I do believe that if we do so, we must articulate a rationale relevant to the particular context at issue and explain why our past reasoning with regard to the jurisdictional nexus is no longer valid.

[21] Proposal at II. A.
[22] See Proposal at II. A.; Guidance, 78 FR at 45312-13.
[23] Guidance, 78 FR at 45312.

More concerning, the proposed “guarantee” definition is narrower in scope than the one used in the Guidance in that it would not include several different financial arrangements and structures that transfer risk directly back to the United States such as keepwells and liquidity puts, certain types of indemnity agreements, master trust agreements, liability or loss transfer or sharing agreements, etc.[24] While in this instance, the Proposal explains the Commission’s rationale for the broader interpretation of “guarantee” for purposes of CEA section 2(i) in the Guidance, and admits that the rationale is still valid, it nevertheless chooses to ignore the truth of the matter and focus on what is more “workable” for non-U.S. persons.[25] Further concerning, as I will explain shortly, the Proposal puts forth that while the proposed “guarantee” definition could lead to entities counting fewer swaps towards their *de minimis* threshold calculation relevant to SD registration as compared to the Guidance, related concerns could be mitigated to the extent such non-U.S. person meets the definition of a “significant risk subsidiary.”[26] In this instance, the Commission is simply ignoring its responsibilities under CEA section 2(i) to save non-U.S. persons a little extra work, or as the Proposal might say, “overly burdensome due diligence.”[27]

SOS on SRS

The introduction of the “significant risk subsidiary” or “SRS” is perhaps the most elaborate departure from the Commission’s interpretation of CEA section 2(i) and almost seems to be an attempt to ensure that no non-U.S. subsidiary of a U.S. parent entity will

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[24] Proposal at II. B; *See* Guidance 78 FR at 45320, n. 267.
[25] *Id.*
[26] *Id.*
[27] Proposal at II.

ever have to consider its swap dealing activities for purposes of the relevant SD or MSP registration threshold calculations. Save for a single footnote reference to a request for comment and passing references to SRSs likely being classified as conduits in the explanation of Cost-Benefit Considerations, the Proposal does not mention anything regarding the Guidance's concept of a conduit affiliate—despite the fact that the SEC includes the concept of conduit affiliate in its definitions relevant to cross-border security-based swap dealing activity.[28] Rather, instead of elaborating on whether and how the concept of conduit affiliates described in the Guidance failed to achieve its purpose, is no longer relevant, resulted in loss of liquidity, fragmentation, proved unworkable, etc., or should be deleted from all frame of reference in favor of harmonizing with the SEC, the Proposal simply introduces the SRS as a new category of person and walks through an elaborate analysis that really begins where it ends—an exclusion. It is a policy decision of the worst ilk because it masquerades as a solution by diminishing the problem.

SRSs represent a tiny subset of the consolidated non-U.S. subsidiaries of U.S. parent entities that the Commission believes are of supervisory interest in light of their clear potential to permit U.S. persons to accrue risk that, in the aggregate, may have a significant effect on the U.S. financial system or may otherwise be used for evasion.[29] The Proposal's stated rationale for targeting only a subset of non-U.S. subsidiary relationship focuses on comity and the application of a risk-based approach acts like a sieve on CEA section 2(i) such that only the largest entities that themselves as individual

[28] *See* 17 CFR 240.3a71-3(a)(1).
[29] Proposal at II.C.1.

entities may pose risk to the financial system. An approach that outright acknowledges the potential for widespread swap activities within the scope of CEA section 2(i), which could ultimately result in significant risk being transferred back to U.S. parent entities, only to be met with a bright line induced shrug by the Commission – is simply untenable.

Rather than rehashing the elements of the SRS definition, I will focus on two aspects that I find most troubling. First is the requirement that the U.S. parent entity meet a $50 billion consolidated asset threshold. This threshold is intended to limit the SRS definition to only those entities whose U.S. parent entity may pose a systemic risk to the U.S. financial system. Foremost, given CEA section 2(i)'s focus on activities in the aggregate, a bright line threshold at the entity level is irrelevant. Not to mention that if Congress had wanted the Commission to focus its cross-border authority on systemically significant entities, it would have used language that was not so embedded in common law[30] or would have articulated that directive clearly in the Dodd-Frank Act.[31]

Second, even if a non-U.S. person met one of three tests for being a significant subsidiary of a U.S. parent with over $50 billion in consolidated assets, it would not be an SRS if it is either subject to prudential regulation as a subsidiary of a U.S. bank holding company or subject to comparable capital and margin standards and oversight by its home country supervisor. While I believe these exclusions are appropriate in the context

[30] *See, e.g.* Proposal at I.C.1.; Guidance 81 FR at 45298-300; *See SIFMA v. CFTC,* 67 F.Supp.3d at 427 ("Congress modeled Section 2(i) on other statutes with extraterritorial reach that operate without implementing regulations." (citations omitted); *See* Larry M. Eig, Cong. Research Serv., 97-589, Statutory Interpretation: General Principles and Recent Trends 20 (2014) (Congress is presumed to legislate with knowledge of existing common law.").

[31] *Id.* at 16-17 ("where Congress includes particular language in one section of a statute but omits it in another…, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." (quoting *Atlantic Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 433 (1933))).

of the policy the Proposal is putting forward in its vision of the SRS, I am concerned that we are substituting our oversight with that of the Federal Reserve Board, in one instance, on the grounds that being subject to consolidated supervision and regulation by the Federal Reserve Board with respect to capital and risk management requirements provides appropriate regulatory coverage. While I do not disagree with respect to risk management that the Federal Reserve Board provides comparable oversight, finding that comparability satisfies our regulatory oversight concerns in this instance may lead us down a slippery slope in which we find ourselves fighting to maintain our own Congressionally delegated jurisdiction with respect to swaps activities. This fact is only further validated— considering the breadth of the exclusions—by the high likelihood that a non-U.S. subsidiary of a U.S. parent entity with over $50 billion in consolidated assets is a financial entity subject to some form or prudential regulation in its home jurisdiction. Indeed, the Proposal suggests that of the current population of 59 SDs, "few, if any, would be classified as SRSs."[32]

While the concept of an SRS is interesting to me, the Proposal's attempt to draw multiple bright lines in a web of interconnectedness almost ensures that risk will find an alternate route back to the U.S. with potentially disastrous results. Without a better understanding of how the SRS proposal would work in practice and whether it is truly better than the conduit affiliate concept currently outlined in the Guidance and presumably similar to the SEC's own approach, it is difficult to get behind a policy that

[32] Proposal at VII. C.2.i.

could most certainly bring risk into the U.S. of the very type CEA Section 2(i) seeks to address.

ANE—Anyone? Anyone?

The issue of how to address the application of certain transaction-level requirements with respect to swap transactions arranged, negotiated, or executed by personnel or agents located in the United States of non-U.S. SDs (whether affiliates or not of a U.S person) with non-U.S. counterparties ("ANE Transactions") is one aspect of the Commission's cross-border approach that has continually raised concerns and demands greater certainty. First articulated in a 2013 Staff Advisory,[33] the issue boils down to whether transactional requirements apply to ANE swaps, and if so, whether substituted compliance may be available. A 2014 Commission Request for Comment[34] sought to address the complex legal and policy issues raised by the 2013 Staff Advisory. It was followed by the Commission's 2016 Proposal, which among other things, addressed ANE transactions, including the types of activities that would constitute arranging, negotiating, and executing within the context of the 2016 Proposal, and the extent to which the SD registration threshold and external business conduct standards apply with respect to ANE Transactions.[35] Today's Proposal withdraws the 2016

[33] *See* CFTC Staff Advisory No. 13-69, Applicability of Transaction-Level Requirements to Activity in the United States (Nov. 14, 2013), *http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/13-69.pdf*.
[34] *See* Request for Comment on Application of Commission Regulations to Swaps Between Non-U.S. Swap Dealers and Non-U.S. Counterparties Involving Personnel or Agents of the Non-U.S. Swap Dealers located in the United States, 79 FR 1347 (Jan. 8, 2014) ("2014 Request for Comment").
[35] *See* Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants, 81 FR 71946 (Oct. 18, 2016).

Proposal on grounds that the Commission's views have changed and evolved as a result of market and regulatory developments and "in the interest of international comity."[36]

The proposal sets forth an approach largely based on comments to the 2014 Request for Comment[37] and seemingly in response to a recommendation made in an October 2017 report of the U.S. Treasury Department that both the CFTC and SEC "reconsider the implications of applying their Title VII rules to transactions between non-U.S. firms or between a non-U.S. firm and a foreign branch or affiliate of a U.S. firm merely on the basis that U.S. located personnel arrange, negotiate, or execute the swap, especially for entities in comparably regulated jurisdictions."[38] The proposed approach is simply to ignore ANE Transactions within the scope of the Proposal as irrelevant "because the transactions involve two non-U.S. counterparties, and the financial risk of the transactions lies outside the United States…"[39] That may be the case in some circumstances; however, casting an overly broad net on a category of activities may run the risk of slippage, and I am concerned we have not given this important element of our cross-border jurisdiction enough thought to warrant such an expeditious solution.

Conclusion

Despite my concerns regarding this Proposal, I look forward to hearing constructive input from market participants and the public. I am encouraged by the balanced nature of the requests for comment, and would like to modestly request that in

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[36] Proposal at I.A.
[37] Indeed, the discussion of the seventeen comments to the 2014 Request for Comment in the 2016 Proposal is nearly identical to that of the Proposal. *See*, 2016 Proposal, 81 FR at 71946, 71952-3; Proposal at V.
[38] *See* U.S. Dep't of the Treasury, A Financial System that Creates Economic Opportunities: Capital Markets 135-136 (Oct. 2017), *https://home.treasury.gov/system/files/136/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf*.
[39] Proposal at V.

responding to the Proposal, commenters indicate whether they believe it is appropriate and prudent for the Commission to proceed with a rulemaking at this time, or whether the preference is to adhere to the current Guidance, or some hybrid of the two.

As with all rulemakings, input the Commission receives through public comment drives the conversation, and sets us on a course that balances diverse interests; seeks transparency, resiliency, and efficiency; and above all else, focuses on protecting U.S. markets, its participants and most importantly the customers that rely on this truly global marketplace. One might assume that making targeted, surgical changes to an existing regulatory framework is easier than creating a framework. But, in some circumstances, it is exactly the opposite. Global swaps markets have grown and evolved around rule sets that were completed and implemented in the very recent past. As regulators I believe we should caution against any wholesale rewrite when we find well regulated, transparent, and generally well running financial markets. But, if we do find vulnerabilities or inefficiencies in our rules (certainly both old and new), the process to reconsider should be deliberate, balanced, and inclusive to ensure the Commission, as a collective body, understands the gravity of its decisions.

Appendix 5—Dissenting Statement of Commissioner Dan M. Berkovitz

I dissent from today's cross-border swap regulation proposal (the "Proposal") because it would significantly weaken the Commission's existing regulatory framework that protects the United States from risky overseas swaps activity. The existing cross-border framework has worked well over the past six years to protect the U.S. financial system from risks from cross-border swaps activity, while simultaneously enabling U.S.

banks to compete successfully in overseas markets.[1] The Proposal would create multiple loopholes for U.S. banks to evade the Commission's oversight of their cross-border activity and pose risks to the U.S. financial system. With a wink and a nod, U.S. banks could effectively guarantee their overseas swap dealing affiliates from losses while also enabling those affiliates to escape regulation as swap dealers. The Proposal would enable U.S. banks to book their swap trades in unregistered foreign affiliates that would not be required to report their swaps in the United States, and would not be subject to our capital, margin, and risk management requirements.

The Proposal also sends us down a rabbit hole with a complex new entity designation, "Significant Risk Subsidiary" ("SRS"). An SRS would be a type of overseas swap dealing affiliate that in theory is subject to greater Commission oversight. The Proposal admits, however, that there would be "few, if any," entities in this elusive category.[2] What is the purpose of creating a complicated category that does not include a single entity? This is a Seinfeldian regulation—a regulation about nothing.[3]

The Proposal would transform the Commission from a watchdog guarding U.S. shores into a timid turtle, reluctant to poke its head out of its domestic shell. When the

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[1] U.S. banks are the strongest in the world. The Global League Tables ranking global banks by amount of banking business activity shows that three or four U.S. banks are in the top five banks in almost every category, including for banking business in foreign markets. *See* GlobalCapital.com, Global League Tables, available at *https://www.globalcapital.com/data/all-league-tables*. While we could not locate a global ranking of banks by swap business, GlobalCapital.com selected Bank of America Merrill Lynch as "derivatives house of the year" and four of the seven other banks shortlisted for the award were U.S. banks. *See* Ross Lancaster, *Global Derivatives Awards 2019: the winners*, GlobalCapital.com (Sept. 26, 2019), available at *https://www.globalcapital.com/article/b1h9txdc91yw4k/globalcapital-global-derivatives-awards-2019-the-winners*. By comparison, in 2006, "Deutsche Bank dominate[d] in every region" in the competition for derivatives house of the year. *See* Yassine Bouhara, *Global Derivatives House of the Year*, GlobalCapital.com, (Nov. 9, 2006), available at *https://www.globalcapital.com/article/k64qjpc6mxwc/global-derivatives-house-of-the-year*.

[2] *See* Proposal, section VII.C.2(i).

[3] *See* Wikipedia.org, *Seinfeld*, available at *https://en.wikipedia.org/wiki/Seinfeld*.

next financial crisis arrives, will foreign governments bail out affiliates of U.S. persons located in their jurisdictions? Experience has taught us that while finance may be global, global financial rescues are American. With today's Proposal, I fear that the U.S. tax payer will once again be called on to bear the costs. We've been down this de-regulatory road before, and it ended in disaster for the United States and the global financial system. Congress enacted the Dodd-Frank Act to avoid these same mistakes, yet today the Commission is voting out a proposal that ignores both those lessons and the law.

Why Cross-Border Swaps Must be Regulated by the CFTC

It seems that every few years, we must remind ourselves of why regulating cross-border financial transactions, and swaps in particular, is important to managing systemic risk. If we forget, the financial system delivers its own destructive reminders. Examples from recent history prove that foreign financial activity, usually involving swaps, can lead to massive losses triggering the need for emergency action by the Department of the Treasury and/or the Federal Reserve System—sometimes at the expense of the U.S. taxpayer. As described later in my statement, the Proposal would undermine the direction in CEA section 2(i) to regulate cross-border swap activity, and again allow such activity by U.S. financial institutions to go unobserved and unsupervised.

In 1998, the U.S. hedge fund Long-Term Capital Management L.P. ("LTCM") was saved from failure through an extraordinary bailout by 15 banks. The bailout was brokered by the Federal Reserve Bank of New York. The near failure of LTCM roiled financial markets. The financial system could have seized up if LTCM had failed because of the large and opaque derivatives exposures that many U.S. banks had with

LTCM.[4] Although LTCM was mostly managed from Connecticut, it was a Cayman Islands entity with over a dozen affiliates, only $4 billion in capital, and a complex derivatives book with a notional amount in excess of $1 trillion.[5]

In 2007, U.S.-based Bear Stearns provided loans intended to shore up two Cayman Islands hedge funds sponsored by Bear Stearns. Bear Stearns was not legally obligated to back the funds financially. Those actions were the beginning of a chain of events that eventually led to the fire sale of Bear Stearns to J.P. Morgan in March 2008. To entice J.P. Morgan to buy a distressed Bear Stearns, the Federal Reserve System provided financial support for the purchase.[6] This is not to suggest that Bear Stearns failed solely because of swap activity, but to illustrate how financial institutions are essentially obligated to support foreign affiliated entities even when they do not guarantee performance, and how such support can have serious consequences to the U.S. financial system.

Walter Wriston, former chairman and CEO of Citicorp, testified to Congress regarding the obligation of a parent bank to bail out a subsidiary, no matter the degree of legal separation: "It is inconceivable that any major bank would walk away from any subsidiary of its holding company. If your name is on the door, all of your capital funds

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[4] *See* The President's Working Group on Financial Markets, Hedge Funds, Leverage, and the Lessons of Long-Term Capital Management (Apr. 1999) available at *http://www.treasury.gov/resource-center/fin-mkts/Documents/hedgfund.pdf*; *see also* International Monetary Fund, *World Economic Outlook and International Capital Markets* (Dec. 1998), available at *https://www.imf.org/external/pubs/ft/weo/weo1298/pdf/file3.pdf*.
[5] *Id.*
[6] *See* Reuters, *Timeline: A dozen key dates in the demise of Bear Stearns* (Mar. 17, 2008), available at *https://www.reuters.com/article/us-bearstearns-chronology/timeline-a-dozen-key-dates-in-the-demise-of-bear-stearns-idUSN1724031920080317*.

are going to be behind it in the real world. *Lawyers can say you have separation, but the marketplace is persuasive, and it would not see it that way*."[7]

When Lehman Brothers went bankrupt and triggered the 2008 financial crisis, its London affiliate, Lehman Brothers International Europe, had a book of nearly 130,000 swaps that took many years to resolve in bankruptcy.[8] Soon thereafter, American International Group would have failed as a result of swaps trading by the London operations of a subsidiary, AIG Financial Products, if not for over $180 billion of support from the Federal Reserve System and the U.S. Department of Treasury. [9]

In 2012, on the eve of the swap dealer regulations going into effect, J.P. Morgan Chase & Co. disclosed multi-billion dollar losses from credit-related swaps managed through its London chief investment office. While this loss did not require the Treasury or the Federal Reserve System to act, it did result in an enforcement action by the CFTC. The enforcement order detailed how the trading activity that caused the loss would have been subject to tighter controls and oversight—and likely would not have happened—if the activity had been subject to swap dealer regulation by the CFTC.[10]

Each of these very substantial financial failures occurred at least in part because of overseas activity by U.S. financial institutions. Although the activity occurred away

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[7] *See https://en.wikipedia.org/wiki/Walter_Wriston* (citing Financial Institutions Restructuring and Services Act of 1981, Hearings on S. 1686, S. 1703, S. 1720 and S. 1721, before the Senate Committee on Banking, Housing, and Urban Affairs, 97th Congress, 1st Session, Part 11, 589-590) (italics added).

[8] *See* Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 FR 45292, 45294 (July 26, 2013) ("2013 Guidance").

[9] *Id.* at 45293-94.

[10] *See In re JPMorgan Chase Bank, N.A.*, CFTC No. 14-01, 2013 WL 6057042, at *6-8 (Oct. 16, 2013), available at *https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfjpmorganorder101613.pdf*.

from the United States, and was not subject to direct U.S. regulatory oversight, the risks and the costs both came back to the United States.

Foreign derivatives activity is of particular concern because derivatives are, by their very nature, contracts that can transfer large amounts of risk between entities and across borders. Congress recognized this concern when it adopted CEA section 2(i) applying the swaps provisions of the Dodd-Frank Act to regulate cross-border swaps activity that has a "direct and significant connection with activities in, or effect on, commerce of the United States." Notably, this cross-border jurisdiction is both activity-based as well as effects-based. It is the nature of the activity and its connection to commerce in the United States—not simply the level of risk presented—that is the basis for the CFTC's cross-border jurisdiction. Congress recognized that we cannot always foresee the risks presented by swap activities. By supposedly focusing on risk, the Proposal ignores this crucial insight and critical component of the Commission's cross-border jurisdiction.

But even with respect to activities presenting serious risks to the United States, the Proposal gets it wrong. The risks incurred by foreign affiliates are transferred, or otherwise inure, to the U.S. parent firms in several ways. The traditional method was for the U.S. parent to guarantee the swap payment obligations of its foreign affiliates. Swap dealers removed many of those formal, written guarantees that were executed prior to the financial crisis in 2014 after the 2013 Guidance was issued (more on that later). Alternatively, using inter-affiliate swaps, a foreign affiliate typically transfers to its U.S. parent all of the risk it incurs in a swaps portfolio. While the U.S. parent may not be directly liable to the counterparties of its foreign affiliate, any losses of the affiliate are equivalent to losses the parent incurs on its swap with the affiliate. If the affiliate makes bad bets, the parent pays for them. Finally, a U.S. parent can be less directly responsible for its foreign affiliate's swap obligations through capital contribution arrangements (e.g., keepwell agreements or deed-poll arrangements), or simply because letting an affiliate fail and default to numerous foreign entities is untenable as a business matter. As Walter Wriston noted, as a matter of market survival a U.S. bank would not allow a wholly-owned affiliate to fail and default on its swap obligations.

The Commission's regulation of cross-border swap activity should address all of these risk transfer conduits. At the same time, it should be flexible enough to allow U.S. banks to compete in global markets. In my view, the 2013 Guidance and the attendant no action relief achieved the right balance and is working well. As noted above, U.S. banks are competing throughout the world. In fact, they are out-competing their non-U.S. competitors. There is no persuasive reason to weaken a regulatory standard that is consistent with our law and that has successfully protected the American people for the last six years—*while simultaneously witnessing the global preeminence of American banks*. The Proposal snatches defeat from the jaws of victory.

The Proposal would greatly weaken the Commission's ability to monitor and regulate foreign swap activity by U.S. financial institutions, putting our financial system at risk once again. Only ten years after the financial crisis, the Proposal tosses aside hard lessons learned at the expense of 10% unemployment, millions of foreclosures, massive bailouts, and lasting damage to the economic fortunes of tens of millions of our fellow citizens. It does this in the interest of secondary considerations—harmonization, a "workable framework" for regulations, and reducing costs. Whereas "legal certainty" was the buzzword to limit the CFTC's jurisdiction over the swaps market in the 1990s and 2000s, today's de-regulatory mantra includes "harmonization," "reducing fragmentation," and "deference." Call it what you like, but the results are intended to be the same: preventing the CFTC from overseeing the swaps activity of major U.S. banks. Creating the possibility for another taxpayer-funded bailout for overseas swap activity cannot possibly be the right outcome for the American people.

What is Wrong with the Proposal

The Proposal starts on a good note by essentially adopting the interpretation of CEA section 2(i) contained in the 2013 Guidance. The Proposal also acknowledges that "a global financial enterprise effectively operates as a single business, with a highly integrated network of business lines and services conducted through various branches or affiliated legal entities that are under the control of the parent entity."[11] It then explains that the entities in a global financial enterprise provide "financial or credit support to each other, such as in the form of a guarantee or the ability to transfer risk through inter-affiliate trades or other offsetting transactions."[12] The Proposal then uses the basic framework of the 2013 Guidance and adopts some of its substantive provisions.

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[11] Proposal, section I.B. (noting that large U.S. banks have thousands of affiliated entities around the world.)

[12] *Id*. The Proposal notes that "even in the absence of an explicit arrangement or guarantee, the parent entity may, for reputational or other reasons, choose or be compelled to assume the risk incurred by its affiliates, branches, or offices located overseas."

But the Proposal makes a number of changes to key provisions, all geared toward limiting the application of our regulations. Most concerning are the narrowing of the definition of "guarantee" and "U.S. persons," and codifying full relief for arranging, negotiating, or executing ("ANE") swaps in the United States that are then booked in non-U.S. legal entities. Together, these provisions in the Proposal create a loophole through which U.S. financial institutions can undertake substantial swap dealing activity outside the U.S. swap regulatory regime through unregistered foreign affiliates and bring the risks they incur back to the United States. In addition, these key provisions allow U.S. persons to undertake substantial dealing activity *inside* the United States and then evade regulation by booking the trades in foreign entities. Together, these provisions will codify a framework for circumventing our swap regulations greatly undermining CEA section 2(i) and Title VII of the Dodd-Frank Act.

I am concerned that codifying this result will encourage U.S. banks to book much of their swap dealing activity in foreign affiliates that limit their swap dealing with U.S. persons and therefore will not have to register as swap dealers. Under the narrowed definition of "guarantee" in the Proposal, the U.S. parents would be able to provide full financial support to these unregistered foreign affiliates, just not in the form of an explicit, direct swap payment guarantee. Furthermore, these changes will allow two U.S. entities, whether they are, for example, two global banks or a global bank and a large U.S. corporation, insurance company or hedge fund, to trade with each other without subjecting that trade to U.S. oversight so long as the trade is booked in foreign affiliates.

Finally, by largely eliminating the ANE requirement,[13] those U.S. firms can use their employees in the United States for that trading activity and still evade U.S. regulation if the swaps are booked in foreign affiliates. As discussed above and acknowledged in the Proposal, the U.S. parents will still be on the hook because the risks incurred by the foreign affiliates is transferred back to the U.S. parent through swaps with the affiliate and/or through other capital support mechanisms.

This outcome is not merely an issue of whether the foreign affiliates of U.S. persons need to register as swap dealers. By not registering, these foreign affiliates will not need to report their swap activity to CFTC registered swap data repositories. They will not be subject to our margin, capital, and risk management requirements. These firms will not be subject to the swap dealing best practices that our regulations require. CEA section 2(i) will be undermined.

The three changes in the Proposal are intended to address unintended effects on previously standard business practices that helped U.S. banks compete in global markets. A foreign counterparty that is not headquartered in the United States (a "true non-U.S. entity") may not want to trade with affiliates of U.S. banks, or with bank employees in the United States, if doing so means the true non-U.S. entity would need to count those swaps toward its CFTC swap dealer registration threshold.

Under the 2013 Guidance, guaranteed foreign affiliates of U.S. banks are deemed U.S. persons for purposes of counting dealing swaps with U.S. persons. The term "guarantee" was defined broadly. Once it became apparent that true non-U.S. entities did

[13] At my request, the preamble to the Proposal was modified to clarify that our anti-fraud and anti-manipulation regulations never the less apply to the conduct occurring in the United States.

not want to count those swaps, U.S. banks de-guaranteed their foreign affiliate swap dealers. The 2016 cross border proposal[14] tried to adjust the guidance framework by adding back into the U.S. person definition foreign consolidated subsidiaries ("FCS") that are consolidated on the books of a U.S. parent. However, that would have the effect of exacerbating the problem for U.S. banks competing for swap business with true non-U.S. entities. The Proposal discards the FCS concept and narrows the definition of a "guarantee" to solely an explicit recourse of the counterparty to the U.S. parent for payment on the swap. The Proposal further narrows the U.S. person definition to delete full recourse subsidiaries and eliminate conduit affiliates treatment for the same reasons.

I am highly skeptical that the status quo will be maintained if the ANE no action relief and de-guaranteeing framework are codified. Large U.S. banks would have incentives to de-register some of their foreign affiliate swap dealers. They are likely to maintain only one or two foreign entities that are registered to handle business with U.S. persons operating in foreign jurisdictions who want to trade with registered swap dealers. Even if they do not de-register those swap dealers, swap activity can easily be moved to other unregistered foreign affiliates that are supported by their U.S. parents in ways other than an explicit swap payment obligation guarantee.

There is a potential alternative for addressing the concerns of true non-U.S. entities without also excluding from oversight all activity of foreign affiliates of U.S. financial institutions. The regulations potentially could provide that, with substituted compliance determinations in place for key swap regulations (e.g. margin and risk

[14] Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants, 81 FR 71946 (Oct. 18, 2016).

management), true non-U.S. entities can trade with foreign affiliates of U.S. entities without counting those swaps toward U.S. swap dealer registration. This could be a reasonable balance of systemic safety and competitiveness.

At the same time, foreign entities that are wholly owned by U.S. parents would still be required to count swaps with other wholly-owned foreign affiliates of other U.S. parents. In this way, U.S. financial institutions can compete for foreign swap business while preventing U.S. firms from evading swap regulation by booking swaps with each other in foreign affiliates.

I invite commenters to address this potential solution.

Seinfeldian Regulation: Significant Risk Subsidiary

The Proposal contains a new regulatory construct called the "Significant Risk Subsidiary" ("SRS"). It is a putative replacement for a broader definition of guarantee and the FCS alternative. But it appears to be an empty set. The Cost-Benefit Considerations project that "few, if any" entities would fall within its ambit. It would not accomplish anything.

The SRS is a very complicated construct, with no less than six tests for determining whether a firm would qualify for regulation as an SRS. Bizarrely, none of these tests have anything to do with the amount of the entity's swap activity. The basic threshold is that the entity be affiliated with a commercial enterprise with at least $50 billion in capital. Consider this: LTCM had $4 billion in capital and a derivatives book with a notional amount of about $1 trillion at the time it was bailed out.

Another hurdle excludes any entity regulated by U.S. or foreign banking regulators. In effect, the entities that do the vast majority of swap dealing in the world are excluded from the SRS definition. With so many hurdles for the SRS determination, it appears that the Proposal has little interest in actually contributing to the control of systemic risk exposure in the U.S. financial system. The reasoning goes, if the entity is regulated by a banking regulator that follows basic Basel capital and supervision standards, then CFTC regulation is unnecessary.[15] But Congress decided in 2010 when it adopted the Dodd-Frank Act that swap dealing needed to be separately regulated from prudential bank regulation. The catastrophic cross border financial failures discussed previously in this statement demonstrate why these additional protections are necessary. Prudential regulation alone was insufficient to prevent those failures and risks to the financial system. Those failures eventually required emergency action by the Federal Reserve System and/or the Department of the Treasury.

Substituted Compliance Shortcomings

I support the principle of international comity. The CFTC should continue to recognize the interests of other countries in regulating swap activity occurring within their borders. The 2013 Guidance has a flexible, outcomes based substituted compliance review process based on a finding that the foreign regulated entities are subject to

[15] "An entity that meets either of these two exceptions, in the Commission's preliminary view, would be subject to a level of regulatory oversight that is sufficiently comparable to the Dodd-Frank Act swap regime with respect to prudential oversight. . . . In such cases where entities are subject to capital standards and oversight by their home country regulators that are consistent with Basel III and subject to a CFTC Margin Determination, the Commission preliminarily believes that the potential risk that the entity might pose to the U.S. financial system would be adequately addressed through these capital and margin requirements." Proposal, at II.C.4.

comparable, comprehensive supervision and regulation.[16] The standard of review is effectively the same as the standard established by Congress in CEA sections 4(b)(1)(A), 5b(h), and 5h(g) for finding, respectively, foreign boards of trade, swap execution facilities, and exempt derivatives clearing organizations comparable.

The Proposal would apply a lesser standard. It would permit the Commission to issue a comparability determination if it determines that "some or all of the relevant foreign jurisdiction's standards are comparable." The condition that the regulations be "comprehensive" is dropped. Furthermore, unlike the 2013 Guidance and the CEA comparability analysis, which require the Commission to make a comparability determination or finding based on the standard, the Proposal says that the Commission can consider any factors it "determines are appropriate, which *may* include"[17] four factors listed. This arbitrary, non-standard "standard" creates too much uncertainty and flexibility. The Commission should not defer regulating U.S. bank affiliates to other regulatory jurisdictions operating under a lesser standard than the Commission has previously used in this context or currently uses in other contexts.

Conclusion

The Proposal would allow U.S. banks to evade swap regulation by booking swaps in non-U.S. affiliates. The Proposal would enable U.S. banks to arrange, negotiate, and execute swaps in New York, but avoid swap regulation by booking those swaps in their

[16] "[T]he Commission will rely upon an outcomes-based approach to determine whether these requirements achieve the same regulatory objectives of the Dodd-Frank Act. An outcomes-based approach in this context means that the Commission is likely to review the requirements of a foreign jurisdiction for rules that are comparable to and as comprehensive as the requirements of the Dodd-Frank Act, but it will not require that the foreign jurisdiction have identical requirements to those established under the Dodd-Frank Act." 2013 Guidance, 78 FR 45292, 45342-3.
[17] Proposal, rule text section 23.23(g)(4).

non-U.S. affiliates. A non-U.S. affiliate of a U.S. bank could enter into trillions of dollars of swaps with non-U.S. affiliates of other U.S. entities without registering with the CFTC as a swap dealer. The U.S. parent bank could provide full financial support for those non-U.S. affiliates so long as the support does not come in the narrow form of an explicit swap payments guarantee.

Ultimately, the risk from all of those swaps will still be borne by the parent bank in the United States. These risks can be very large. The activities of bank affiliates outside the United States have a direct and significant connection with activities in, or effect on, commerce in the United States. In Title VII of the Dodd-Frank Act, the Congress directed the CFTC to apply its swap regulations to these activities. Because the Proposal retreats from these responsibilities, I dissent.

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