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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: Final rule.

SUMMARY: The Commodity Futures Trading Commission ("Commission" or "CFTC") is adopting a final rule ("Final 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"). The Final 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 Final Rule adopts a risk-based approach that, consistent with the applicable section 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, advances the goals of the Dodd-Frank Act's swap reforms, while fostering greater liquidity and competitive markets, promoting enhanced regulatory cooperation, and improving the global harmonization of swap regulation.

DATES: The Final Rule is effective [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. Specific compliance dates are set forth in the Final Rule.

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I. Background

A. Statutory Authority and Prior Commission Action

In 2010, the Dodd-Frank Act[1] amended the CEA[2] 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.[3]

In May 2012, the CFTC and Securities and Exchange Commission ("SEC") jointly issued an adopting release that, among other things, further defined and provided registration thresholds for SDs and MSPs in § 1.3 of the CFTC's regulations ("Entities Rule").[4]

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[1] Pub. L. 111–203, 124 Stat. 1376 (2010).

[2] 7 U.S.C. 1 *et seq.*

[3] 7 U.S.C. 2(i).

[4] *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

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").[5] The Guidance included the Commission's interpretation of the "direct and significant" prong of section 2(i) of the CEA.[6] 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 to be 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.[7] 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.[8] At the time that it adopted the Guidance, the Commission was tasked with regulating a market that grew to a global scale without any meaningful regulation in the United States or overseas, and the United States was the first member country of the Group of 20 ("G20") to adopt most of the swap reforms agreed to at the G20 Pittsburgh

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"Eligible Contract Participant," 77 FR 30596 (May 23, 2012). Commission regulations referred to herein are found at 17 CFR chapter I.

[5] *See* Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 FR 45292 (Jul. 26, 2013).

[6] *Id.* at 45297-45301. The Commission is now restating this interpretation, as discussed in section I.D.2 *infra*.

[7] *Id.* at 45297 n.39.

[8] *See id.*

Summit in 2009.[9] 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 V.A).[10] 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").[11] In January 2014, the Commission published a request for comment on all aspects of the ANE Staff Advisory ("ANE Request for Comment").[12]

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[9] *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.

[10] *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. All Commission staff letters are available at https://www.cftc.gov/LawRegulation/CFTCStaffLetters/index.htm.

[11] 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.

[12] 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).

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").[13] 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 assesses 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").[14] 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.[15] The 2016 Proposal also addressed the extent to which SDs and MSPs would be required to comply with the Commission's business conduct standards governing their conduct with swap counterparties ("external business conduct standards") in cross-border transactions.[16] In

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[13] 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).

[14] 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).

[15] *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.

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

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.[17]

B. Proposed Rule and Brief Summary of Comments Received

In January 2020, the Commission published a notice of proposed rulemaking ("Proposed Rule"), which proposed to: (1) address the cross-border application of the registration thresholds and certain requirements applicable to SDs and MSPs; and (2) establish a formal process for requesting comparability determinations for such requirements from the Commission.[18] In the Proposed Rule, the Commission also withdrew the 2016 Proposal, stating that the Proposed Rule reflected the Commission's current views on the matters addressed in the 2016 Proposal, which had evolved since the 2016 Proposal as a result of market and regulatory developments in the swap markets and in the interest of international comity.[19] The Commission requested comments generally on all aspects of the Proposed Rule and on many specific questions.

The Commission received 18 relevant comment letters.[20] Though AFR and IATP did not support the Commission adopting the Proposed Rule in its entirety, most

[17] 2016 Proposal, 81 FR at 71947.

[18] Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 FR 952 (proposed Jan. 8, 2020).

[19] *Id.* at 954.

[20] The Commission received comments from Alternative Investment Management Association ("AIMA"); Americans for Financial Reform Education Fund ("AFR"); Associated Foreign Exchange, Inc. & GPS Capital Markets, Inc. ("AFEX/GPS"); Chris Barnard ("Barnard"); Better Markets, Inc. ("Better Markets"); BGC Partners & Tradition America Holdings, Inc. ("BGC/Tradition"); Chatham Financial ("Chatham"); Citadel ("Citadel"); Commercial Energy Working Group ("Working Group"); Credit Suisse ("CS"); Futures Industry Association ("FIA"); Japan Financial Markets Council & International Bankers

commenters were supportive of the Proposed Rule, generally, or supportive of specific elements of the Proposed Rule. However, many of these commenters suggested modifications to portions of the Proposed Rule, which are discussed in the relevant sections discussing the Final Rule below. In addition, several commenters requested Commission action beyond the scope of the Proposed Rule.[21] Further, IIB/SIFMA requested that the Commission re-visit in the Final Rule the applicability of the Commission's cross-border uncleared swap margin requirements that were addressed in the Cross-Border Margin Rule. The Commission addressed those requirements in the Cross-Border Margin Rule, did not propose modifying them in the Proposed Rule, and therefore is not making any changes to the Cross-Border Margin Rule in this Final Rule.

C. Global Regulatory and Market Structure

As noted in the Proposed Rule, the regulatory landscape is far different now than it was when the Dodd-Frank Act was enacted in 2010.[22] 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 in the world's primary swap

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Association of Japan ("JFMC/IBAJ"); Institute for Agriculture and Trade Policy ("IATP"); Institute of International Bankers & Securities Industry and Financial Markets Association ("IIB/SIFMA"); International Swaps and Derivatives Association ("ISDA"); Japanese Bankers Association ("JBA"); Japan Securities Clearing Corporation ("JSCC"); and State Street Corporation ("State Street"). The Commission also received letters from PT Arba Sinar Jaya, Robert Ware (UIUC), and William Harrington that were not relevant to the Proposed Rule. All comments on the Proposed Rule are available at https://comments.cftc.gov/PublicComments/CommentList.aspx?id=3067.

[21] *See infra* section VIII for a discussion of these comments.

[22] Proposed Rule, 85 FR at 954-955.

trading jurisdictions to implement the G20 commitments.[23] 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. These regimes include central clearing requirements, margin requirements for non-centrally cleared derivatives, and other risk mitigation requirements.[24]

Many swaps involve at least one counterparty that is located in the United States or another jurisdiction that has adopted comprehensive swap regulations.[25] 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 and other market participants. Market fragmentation can also reduce the capacity of financial firms to serve both domestic and international customers.[26] The Final Rule supports 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, it is important to consider how market practices have evolved since the publication of the Guidance. As certain market

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[23] *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; 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.

[24] 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.

[25] *See, e.g.*, 2019 FSB Progress Report; 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.

[26] *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.

participants may have conformed their practices to the Guidance, the Final Rule will ideally cause limited additional costs and burdens for these market participants, 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. For 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.[27] Financial groups often prefer to operate their swap dealing businesses and manage their 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 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

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[27] *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").

branches or affiliated legal entities that are under the control of the parent entity.[28] 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 located overseas. Swaps are also traded by an entity in one jurisdiction, but booked and risk-managed by an affiliate in another jurisdiction. The Final 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.

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

1. Proposed Rule and Discussion of Comments

The Proposed Rule set forth the Commission's interpretation of CEA section 2(i), which mirrored the approach that the Commission took in the Guidance.

Several commenters provided their views on the Commission's interpretation of CEA section 2(i). Better Markets agreed with the Commission's description of the Commission's authority to regulate swaps activities outside of the United States, recognizing that CEA section 2(i)'s mandatory exclusion of only certain, limited non-U.S. activities (*i.e.*, those that do not have a direct and significant connection with activities in, or effect on, U.S. commerce) evidences clear congressional intent to

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[28] 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.

preserve jurisdiction with respect to others. Better Markets stated its belief that this reflects an intent to ensure U.S. law broadly applies to non-U.S. activities having requisite U.S. connections or effects. Better Markets argued, however, that the Commission does not have the discretion to determine whether and when to apply U.S. regulatory requirements based on vague principles of international comity, stating that the Commission has not cited a legally valid basis for its repeated reliance on international comity, where it simultaneously acknowledges direct and significant risks to the U.S. financial system.

BGC/Tradition supported the Commission's analysis related to CEA section 2(i) and what constitutes "direct and significant." Specifically, BGC/Tradition agreed that the appropriate approach is "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 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."

IIB/SIFMA discussed the Commission's interpretation of "direct" in CEA section 2(i) and argued that the Commission should have followed Supreme Court precedent interpreting the "direct effect" test found in the Foreign Sovereign Immunities Act of 1976, which the Court has interpreted to be satisfied only by conduct abroad that has "an immediate consequence" in the United States.[29] IIB/SIFMA argued that a case cited by the Commission as a factor in its interpretation, the Seventh Circuit *en banc* decision in *Minn-Chem, Inc. v. Agrium, Inc.*, was based on considerations that are relevant to the

[29] *See Republic of Argentina v. Weltover*, 504 U.S. 607, 618 (1992).

Foreign Trade Antitrust Improvements Act of 1982 ("FTAIA"),[30]—but *not* section 2(i)—namely that (a) because the FTAIA includes the word "foreseeable" along with "direct," the word "direct" should be interpreted as part of an integrated phrase that includes "foreseeable" effects, and (b) the FTAIA already addresses foreign conduct that has an immediate consequence in the United States through its separate provision for import commerce.[31] But, IIB/SIFMA argued, CEA section 2(i) does not include the word "foreseeable," nor does it include any other provisions addressing foreign conduct that have an immediate consequence within the United States, so the *Minn-Chem* Court's reasoning does not support the Commission's decision to discount the Supreme Court's interpretation of the word "direct" in *Weltover*.

IATP argued that the Commission did not provide a sufficient "international comity" argument to justify deviating from the plain meaning of "direct," nor a sufficient argument to rely on FTAIA case law to interpret "direct." IATP stated its belief that the Commission's reliance on cross-border anti-trust trade law to interpret its statutory authority under CEA section 2(i) is an inconsistent and unreliable foundation for a rule that proposes no measures to prevent or discipline SDs' unreasonable restraint of trade. IATP recommended that the Commission abandon its "restatement" of its CEA section 2(i) authority and rely on a plain reading of CEA section 2(i).

In response to Better Markets' contention that the Commission does not have the discretion to determine whether and when to apply U.S. regulatory requirements based on principles of international comity where it simultaneously acknowledges direct and

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[30] 15 U.S.C. 6a.

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

significant risks to the U.S. financial system, the Commission has followed the Restatement of Foreign Relations law in striving to minimize conflicts with the laws of other jurisdictions while seeking, pursuant to CEA 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 has determined that the rule appropriately accounts for these competing interests, ensuring 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.

With respect to IIB/SIFMA's contention that the Commission erred in its interpretation of the meaning of "direct" in CEA section 2(i), IIB/SIFMA incorrectly asserted that the Commission relied on the Seventh Circuit *en banc* decision in *Minn-Chem, Inc. v. Agrium, Inc.* Rather, the Commission was 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, specifically noting that the Commission's interpretation of CEA section 2(i) is not solely dependent on one's view of the Seventh Circuit's *Minn-Chem* decision,[32] but informed by its overall understanding of the relevant legal principles.

Finally, the Commission disagrees with IATP's advice that the Commission should abandon its interpretation of CEA section 2(i) and proceed with a "plain reading" of the statute. The Commission believes that IATP's assertion that the extraterritorial

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[32] *See* Proposed Rule, 85 FR at 956.

provisions of FTAIA and the case law construing such provisions are not relevant to CEA section 2(i) because the rule is not concerned with the regulation of anti-competitive behavior misconstrues the use that the Commission's interpretation has made of the Federal case law construing the meaning of the word "direct" in CEA section 2(i).[33]

2. Final Interpretation

In light of the foregoing, the Commission is restating its interpretation of section 2(i) of the CEA with its adoption of the Final Rule in substantially the same form as appeared in 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.

[33] *See infra* notes 41-51, and accompanying text.

(i) 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 FTAIA,[34] which provides the standard for the cross-border application of the Sherman Antitrust Act ("Sherman Act").[35] 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.[36] 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;[37] and (2) such effect gives rise to a Sherman Act claim.[38] 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'

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[34] 15 U.S.C. 6a.

[35] 15 U.S.C. 1-7.

[36] 15 U.S.C. 6a.

[37] 15 U.S.C. 6a(1).

[38] 15 U.S.C. 6a(2).

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.'"[39]

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.[40] 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.[41] Relying upon

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[39] 542 U.S. 155, 162 (2004) (emphasis in original).

[40] *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").

[41] Guidance, 78 FR at 45299.

the Supreme Court's definition of the term "direct" in the Foreign Sovereign Immunities Act ("FSIA"),[42] the U.S. Court of Appeals for the Ninth Circuit construed the term "direct" in the FTAIA as requiring a "relationship of logical causation,"[43] such that "an effect is 'direct' if it follows as an immediate consequence of the defendant's activity."[44] 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."[45] 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.'"[46] The Seventh Circuit rejected interpretations of the term "direct" that included any requirement that the consequences be foreseeable, substantial, or immediate.[47] In 2014, the U.S. Court of Appeals for the Second Circuit followed the reasoning of the Seventh Circuit in the *Minn-Chem* decision.[48] 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

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[42] *See* 28 U.S.C. 1605(a)(2).

[43] *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.

[44] *Id.* at 692-93, *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").

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

[46] *Id.*

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

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

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 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,[49] 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."[50] 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.

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[49] *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.").

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

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," "substantial," and "reasonably foreseeable" "effect" on U.S. commerce. 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.[51] 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

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[51] 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.

by interconnections in the swap market.[52] Title VII of the Dodd-Frank Act gave the Commission new and broad authority to regulate the swap market 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.[53]

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[52] *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 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.

[53] 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.

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 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 goal of the Dodd-Frank Act to reduce risks to the resiliency and integrity of the U.S. financial system arising from swap market activities.[54] Consistent with this 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 interpret 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.[55]

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[54] 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.").

[55] 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

Similar interpretations of other federal statutes regulating interstate commerce support the Commission's interpretation here. For example, the Supreme Court has long supported a similar "aggregate effects" approach when analyzing the reach of U.S. authority under the Commerce Clause.[56] The Court phrased the holding in the seminal "aggregate effects" decision, *Wickard v. Filburn*,[57] 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."[58] In another relevant decision, *Gonzales v Raich*,[59] the Court adopted similar reasoning to uphold the application of the Controlled Substances Act[60] 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

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that a swap-by-swap approach to jurisdiction would be "too complex to prove workable." *See Hoffman-LaRoche*, 542 U.S. at 168.

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

[57] 317 U.S. 111 (1942).

[58] 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.*

[59] 545 U.S. 1 (2005).

[60] 21 U.S.C. 801 *et seq.*

connection with activities in, or effect on, U.S. commerce – whether or not an individual swap may satisfy the statutory standard.[61]

(ii) 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."[62] 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."[63]

The Restatement (Third) of Foreign Relations Law of the United States,[64] together with the Restatement (Fourth) of Foreign Relations Law of the United States[65] (collectively, the "Restatement"), states that a country has jurisdiction to prescribe law with respect to "conduct outside its territory that has or is intended to have substantial

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[61] 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.")

[62] *Hoffman-LaRoche*, 542 U.S. at 164.

[63] *Id.* at 165.

[64] Restatement (Third) section 402 cmt. d (1987).

[65] 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).

effect within its territory."[66] The Restatement also counsels 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.[67]

As a general matter, the Fourth Restatement indicates 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."[68] 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."[69] 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.[70]

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

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[66] Restatement (Fourth) section 409 (Westlaw 2018).

[67] 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.").

[68] *Id.* at section 405 cmt. a.

[69] *Id.* at section 407 cmt. a; *see id.* at section 407 Reporters' Note 3.

[70] *Id.* at section 407.

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 Final Rule appropriately accounts for these competing interests, ensuring 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 relevance is the Commission's approach to substituted compliance in the Final Rule, which mitigates 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.

E. Final Rule

The Final Rule identifies which cross-border swaps or swap positions a person will 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).[71] Further, the Commission is adopting several tailored exceptions from, and a substituted compliance process for, certain regulations applicable to registered SDs and MSPs. The Final Rule also creates 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 Final Rule requires SDs and MSPs to create a record of their compliance with the Final Rule and to retain such records in

[71] There were no MSPs registered with the Commission as of the date of the Final Rule.

accordance with § 23.203.[72] The Final Rule supersedes the Commission's policy views as set forth in the Guidance with respect to its interpretation and application of section 2(i) of the CEA and the swap provisions addressed in the Final Rule.[73]

Some commenters provided their views on the Proposed Rule generally. AFR and IATP both argued that, in sum, the Proposed Rule would fatally weaken the implementation of Title VII of the Dodd-Frank Act and its application to CFTC-regulated derivatives markets, and urged the Commission to step back from the course outlined in the Proposed Rule and restore elements of the Guidance and the 2016 Proposal that, they maintained, offered better oversight of derivatives markets. The Commission has considered these comments but believes that the Final Rule generally reflects the approach outlined by the Commission in the Guidance, and has determined that it takes account of conflicts with the laws of other jurisdictions when applying 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, permitting the Commission to discharge its responsibilities to protect the U.S. markets, market participants, and financial system, consistent with international comity.

More specifically, the Final 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 and the Proposed Rule, as well as discussions that the Commission

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[72] *See* Final § 23.23(h)(1).

[73] *See infra* section V for a discussion of certain swap provisions not addressed in the Final Rule.

and its staff have had with market participants,[74] other domestic[75] 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. In determining the extent to which the Dodd-Frank Act swap provisions addressed by the Final Rule 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 to which the activity takes place within the home country's territory.[76] 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 reforms, the Commission's supervisory oversight cannot be confined to activities strictly within the territory of the

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[74] Summaries of such discussions with market participants are included in the relevant public comment file, available on the Commission's website at https://comments.cftc.gov/PublicComments/CommentList.aspx?id=3067.

[75] The Commission has consulted with the Securities and Exchange Commission ("SEC") and prudential regulators regarding the Final 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, 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.

[76] 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.

United States. Rather, the Commission will exercise its supervisory authority outside the United States in order to reduce risk to the resiliency and integrity of the U.S. financial system.[77] 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 limits 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 Final Rule. The Final 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 effect of its choices on market efficiency and competition, as well as the importance of international comity when exercising the Commission's authority. The Commission believes that the Final 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 adopting definitions for certain terms for the purpose of applying the Dodd-Frank Act swap provisions addressed by the Final Rule to cross-border transactions. Certain of these definitions are relevant in assessing whether a

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[77] *See supra* section I.D.

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 are relevant in determining whether certain swaps or swap positions 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 VII).

A. Reliance on Representations – Generally

The Commission acknowledges that the information necessary for a swap counterparty to accurately assess whether its counterparty or a specific swap meets 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.[78] Therefore, the Commission proposed 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.[79] AFEX/GPS supported the proposed written representation language and noted that it would facilitate compliance with the rules.

The Commission is adopting the "reliance on representations" language as proposed.[80] 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

[78] Proposed Rule, 85 FR at 958-59; Cross-Border Margin Rule, 81 FR at 34827; Guidance, 78 FR at 45315.

[79] Proposed § 23.23(a); Proposed Rule, 85 FR at 958-59, 1002.

[80] Final § 23.23(a).

which the person is aware, that it is not accurate. This language is consistent with: (1) the reliance standard articulated in the Commission's external business conduct rules;[81] (2) the Commission's approach in the Cross-Border Margin Rule;[82] 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").[83] A number of commenters also specifically addressed reliance on representations obtained under the Cross-Border Margin Rule or the Guidance for the "U.S. person" and "Guarantee" definitions. These comments are addressed below in sections II.B.5 and II.C.

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

1. Generally

(i) Proposed Rule

As discussed in more detail below, the Commission proposed defining "U.S. person" consistent with the definition of "U.S. person" in the SEC Cross-Border Rule.[84] The proposed definition of "U.S. person" was also consistent with the Commission's statutory mandate under the CEA, and in this regard was largely consistent with the definition of "U.S. person" in the Cross-Border Margin Rule.[85] Specifically, the Commission proposed to define "U.S. person" as:

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[81] *See* 17 CFR 23.402(d).

[82] *See* Cross-Border Margin Rule, 81 FR at 34827.

[83] *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).

[84] Proposed § 23.23(a)(22); Proposed Rule, 85 FR at 959-63, 1003. *See* 17 CFR 240.3a71-3(a)(4); SEC Cross-Border Rule, 79 FR at 47303-13.

[85] *See* 17 CFR 23.160(a)(10); Cross-Border Margin Rule, 81 FR at 34821-24.

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

(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;

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

(4) An estate of a decedent who was a resident of the United States at the time of death.[86]

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) provided 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. Consistent with the SEC, the Commission noted that the principal place of business for a collective investment vehicle ("CIV") would be in the United States if the senior personnel responsible for 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.[89]

Additionally, in consideration of the discretionary and appropriate exercise of international comity-based doctrines, proposed § 23.23(a)(22)(iii) stated that the term "U.S. person" would not include certain international financial institutions.[90]

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[86] Proposed § 23.23(a)(22)(i); Proposed Rule, 85 FR at 959-63, 1003.

[87] Cross-Border Margin Rule, 81 FR at 34823.

[88] 17 CFR 240.3a71-3(a)(4)(ii).

[89] Proposed § 23.23(a)(22)(ii); Proposed Rule, 85 FR at 960, 1003.

[90] Proposed § 23.23(a)(22)(iii); Proposed Rule, 85 FR at 961-62, 1003.

Specifically, consistent with the SEC's definition,[91] 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.

Further, to provide certainty to market participants, proposed § 23.23(a)(22)(iv) permitted reliance, until December 31, 2025, on any U.S. person-related representations that were obtained to comply with the Cross-Border Margin Rule.[92]

(ii) Summary of Comments

In general, AIMA, AFEX/GPS, Barnard, Chatham, CS, IIB/SIFMA, JFMC/IBAJ, JBA, JSCC, and State Street supported the proposed "U.S. person" definition, while IATP generally opposed the proposed definition. Additional comments and suggestions are discussed below.

AIMA, Barnard,[93] Chatham, CS, IIB/SIFMA, JFMC/IBAJ, JSCC, and State Street generally supported the Commission's view that aligning with the SEC's definition of "U.S. person" provided consistency to market participants, noting that the harmonized definition would: (1) provide a consistent approach from operational and compliance perspectives; (2) help avoid undue regulatory complexity for purposes of firms' swaps and security-based swaps businesses; and/or (3) simplify market practice and reduce complexity. AFEX/GPS, Chatham, CS, JFMC/IBAJ, JSCC, and State Street generally

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[91] 17 CFR 240.3a71-3(a)(4)(iii).

[92] Proposed § 23.23(a)(22)(iv); Proposed Rule, 85 FR at 962, 1003.

[93] However, as noted below, Barnard expressed concern regarding other proposed definitions and treatments.

stated that the simpler and streamlined prongs in the proposed “U.S. person” definition allowed for more straightforward application of the definition as compared to the Guidance. Chatham also noted that the proposed definition of “U.S. person” establishes a significant nexus to the United States.

FIA recommended that the Commission explicitly state that the scope of the proposed definition of a “U.S. person” would not extend to provisions of the CEA governing futures commission merchants (“FCMs”) with respect to both: (1) exchange-traded futures, whether executed on a designated contract market or a foreign board of trade; and (2) cleared swaps.

IATP suggested restoring the “U.S. person” definition from the Guidance and 2016 Proposal. IATP argued that the SEC definition applies to the relatively small universe of security-based swaps, and therefore, the Commission should adopt the “U.S. person” and other definitions from the 2016 Proposal for the much larger universe of physical and financial commodity swaps the Commission is authorized to regulate. IATP also asserted that adopting the SEC definition for harmonization purposes was not necessary because SDs and MSPs should have the personnel and information technology resources to comply effectively with reporting and recordkeeping of swaps and security-based swaps. Further, any reduced efficiency would be compensated for by having the “U.S. person” definition apply not only to enumerated entities but to a non-exhaustive listing that anticipates the creation of new legal entities engaged in swaps activities.

(iii) Final Rule

As discussed in more detail below, the Commission is adopting the "U.S. person" definition as proposed, with certain clarifications.[94] In response to IATP, the Commission continues to be of the view that harmonization of the "U.S. person" definition with the SEC is the appropriate approach given that it is straightforward to apply compared to the Guidance definition, and will capture substantially the same types of entities as the "U.S. person" definition in the Cross-Border Margin Rule.[95] In addition, harmonizing with the definition in the SEC Cross-Border Rule is not only consistent with section 2(i) of the CEA,[96] but is also expected to reduce undue compliance costs for market participants. Therefore, as noted by several commenters, the definition will reduce complexity for entities that are participants in the swaps and security-based swaps markets and may register both as SDs with the Commission and as security-based swap dealers with the SEC. The Commission is also of the view that the "U.S. person" definition in the Cross-Border Margin Rule largely encompasses the same universe of persons as the definition used in the SEC Cross-Border Rule and the Final Rule.[97]

In response to FIA, pursuant to § 23.23(a), "U.S. person" only has the meaning in the definition for the purposes of § 23.23. However, to be clear that the definition of

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[94] Final § 23.23(a)(23). Note that due to renumbering, the paragraph references for the definitions in § 23.23(a) of the Final Rule vary from the paragraph references in the Proposed Rule.

[95] *See* Proposed Rule, 85 FR at 959.

[96] 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, section 712(a)(7)(A); 15 U.S.C. 8307(a)(7)(A). *See* Proposed Rule, 85 FR at 959.

[97] *See* Cross-Border Margin Rule, 81 FR at 34824. 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. Proposed Rule, 85 FR at 959.

"U.S. person" is only applicable for purposes of the Final Rule, the rule now includes the word "solely" and reads "*Solely* for purposes of this section . . . ."

Generally, the Commission believes that the 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 Final 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.[98]

Additionally, the Commission is adopting as proposed the definitions for "non-U.S. person," "United States," and "U.S." The term "non-U.S. person" means any person that is not a U.S. person.[99] Further, the Final Rule defines "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.[100] The Commission did not receive any comments regarding these definitions.

2. Prongs

As the Commission noted in the Proposed Rule, paragraph (i) of the "U.S. person" definition identifies certain persons as a "U.S. person" by virtue of their domicile or organization within the United States.[101] The Commission has traditionally looked to where legal entities are organized or incorporated (or in the case of natural persons,

[98] Proposed Rule, 85 FR at 959.

[99] Final § 23.23(a)(10).

[100] Final § 23.23(a)(20).

[101] Proposed Rule, 85 FR at 959.

where they reside) to determine whether they are U.S. persons.[102] 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."[103]

(i) § 23.23(a)(23)(i)(A) and (B)

Paragraphs (i)(A) and (B) of the "U.S. person" definition generally incorporate a "territorial" concept of a U.S. person.[104] 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 generally considers 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 "U.S. person" definition in the Cross-Border Margin Rule[105] and the SEC Cross-Border Rule,[106] 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.[107]

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[102] Cross-Border Margin Rule, 81 FR at 34823; Proposed Rule, 85 FR at 959. *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 ("CPOs")).

[103] Proposed Rule, 85 FR at 959.

[104] *Id*.

[105] *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).

[106] *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.").

[107] *See* Proposed Rule, 85 FR at 959.

The first prong of the proposed definition stated that a natural person resident in the United States would be considered a U.S. person. No comments were received regarding the first prong of the "U.S. person" definition and the Commission is adopting it as proposed.[108]

The second prong of the proposed definition stated that 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 would be considered a U.S. person. In the Proposed Rule, the Commission stated that the second prong of the definition would subsume the pension fund and trust prongs of the "U.S. person" definition in the Cross-Border Margin Rule.[109] No comments were received regarding this aspect of the Proposed Rule and the Commission is adopting it as proposed.[110]

Specifically, the Commission is of the view that, as adopted, § 23.23(a)(23)(i)(B) includes 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)(23)(i)(B), which is a separate prong in the Cross-Border Margin Rule.[111] 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 § 23.23(a)(23)(i)(B).[112]

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[108] Final § 23.23(a)(23)(i)(A).

[109] Proposed Rule, 85 FR at 959-60. *See* 17 CFR 23.160(a)(10)(iv) and (v).

[110] Final § 23.23(a)(23)(i)(B).

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

[112] Proposed Rule, 85 FR at 959.

Additionally, § 23.23(a)(23)(i)(B) subsumes the trust prong of the "U.S. person" definition in the Cross-Border Margin Rule.[113] With respect to trusts addressed in § 23.23(a)(23)(i)(B), the Commission expects that its approach is consistent with the manner in which trusts are treated for other purposes under the law. The Commission has considered that 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 is generally reasonable to treat the trust as a U.S. person for purposes of the Final Rule. Another relevant element in this regard is 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 generally aligns the treatment of the trust for purposes of the Final 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 is generally consistent with its treatment for other purposes.[114]

(ii) § 23.23(a)(23)(i)(D)

Under the fourth prong of the proposed definition, an estate of a decedent who was a resident of the United States at the time of death would be included in the definition of "U.S. person." No comments were received regarding this aspect of the

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

[114] Proposed Rule, 85 FR at 959-60.

Proposed Rule and the Commission is adopting it as proposed.[115] With respect to § 23.23(a)(23)(i)(D), 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.[116] 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.

(iii) § 23.23(a)(23)(i)(C)

The third prong of the definition, the "account" prong, was proposed to ensure that persons described in prongs (A), (B), and (D) 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.[117] Consistent with the Cross-Border Margin Rule, the Commission stated that this prong would apply for individual or joint accounts.[118] IIB/SIFMA recommended that, consistent with the SEC, the Commission clarify that under the "account" prong of the definition, an account's U.S. person status should depend on whether any U.S.-person owner of the account actually incurs obligations under the swap in question.

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[115] Final § 23.23(a)(23)(i)(D).

[116] Proposed Rule, 85 FR at 960.

[117] *Id.*

[118] *Id. See* 17 CFR 23.160(a)(10)(vii).

The Commission is adopting this aspect of the U.S. person definition as proposed, with a clarification.[119] In response to the IIB/SIFMA comment, the Commission is clarifying that an account's U.S. person status depends on whether any U.S. person owner of the account actually incurs obligations under the swap in question. Consistent with the SEC Cross-Border Rule, where an account is owned by both U.S. persons and non-U.S. persons, the U.S.-person status of the account, as a general matter, turns on whether any U.S.-person owner of the account incurs obligations under the swap.[120] Neither the status of the fiduciary or other person managing the account, nor the discretionary or non-discretionary nature of the account, nor the status of the person at which the account is held or maintained, are relevant in determining the account's U.S.-person status.

(iv) Exclusion of Unlimited U.S. Responsibility Prong

Unlike the Cross-Border Margin Rule, the proposed definition of "U.S. person" did 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).[121] The Commission invited comment on whether it should include an unlimited U.S. responsibility prong in the definition of "U.S. person," and if not, whether it should revise its interpretation of "guarantee" in a manner consistent with the SEC such that persons that would have been

[119] Final § 23.23(a)(23)(i)(C).

[120] *See* SEC Cross-Border Rule, 79 FR at 47312.

[121] Proposed Rule, 85 FR at 961. *See* 17 CFR 23.160(a)(10)(vi); Cross-Border Margin Rule, 81 FR at 34823–34824. *See also* Guidance, 78 FR at 45312-13 (discussing the unlimited U.S. responsibility prong for purposes of the Guidance).

considered U.S. persons pursuant to an unlimited U.S. responsibility prong would instead be considered entities with guarantees from a U.S. person.[122]

Chatham and IIB/SIFMA agreed that the Commission should not include an unlimited U.S. responsibility prong in the "U.S. Person" definition, noting that the persons that would be captured under the prong are corporate structures that are not commonly in use in the marketplace (*e.g.*, unlimited liability corporations, general partnerships, and sole proprietorships). IIB/SIFMA added that to the extent a firm uses this structure, the Commission can sufficiently address the resulting risks to the United States by treating the firm as having a guarantee from a U.S. person, as the SEC does.

The Commission is adopting as proposed a definition of "U.S. person" that does not include an unlimited U.S. responsibility prong. Although this corporate structure may exist in some limited form, the Commission does not believe that justifies the cost of classification as a "U.S. person." This prong was designed to 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.[123] 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

[122] Proposed Rule, 85 FR at 969.

[123] *Id.* at 960-961.

calculations as a guarantee.[124] Therefore, as discussed below with respect to the definition of "guarantee," the Commission is clarifying that 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 will be considered as having a guarantee from a U.S. person, similar to the approach in the SEC Cross-Border Rule. The CFTC's anti-evasion rules address concerns that persons may structure transactions to avoid classification as a U.S. person.[125]

The treatment of the unlimited U.S. liability prong in the Final Rule does not affect 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.[126]

(v) Exclusion of Collective Investment Vehicle Prong

Consistent with the definition of "U.S. person" in the Cross-Border Margin Rule and the SEC Cross-Border Rule, the proposed definition did not include a commodity pool, pooled account, investment fund, or other CIV that is majority-owned by one or more U.S. persons.[127] This prong was included in the Guidance definition. The Commission invited comment on whether it is appropriate that commodity pools, pooled

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[124] SEC Cross-Border Rule, 79 FR at 47308 n.255, 47316-47317.

[125] *See* 17 CFR 1.6.

[126] Proposed Rule, 85 FR at 961.

[127] *Id.* *See* Cross-Border Margin Rule, 81 FR at 34824; SEC Cross-Border Rule, 79 FR at 47311, 47337.

accounts, investment funds, or other CIVs that are majority-owned by U.S. persons would not be included in the proposed definition of "U.S. person."[128]

AIMA, Chatham, IIB/SIFMA, JFMC/IBAJ,[129] JBA, and State Street supported not including this prong in the "U.S. person" definition. They generally noted that there are practical difficulties in tracking the beneficial ownership in CIVs, and therefore, including a CIV prong would increase the complexity of the "U.S. person" definition. AIMA stated that this could necessitate conservative assumptions being made to avoid the risk of breaching regulatory requirements that depend on the status of investors in the vehicle. JBA noted that non-U.S. persons may choose not to enter into transactions with CIVs in which U.S. persons are involved to avoid the practical burdens of identifying and tracking the beneficial ownership of funds in real-time and the excessive cost arising from the registration threshold calculations. JFMC/IBAJ elaborated that ownership composition can change throughout the life of the vehicle due to redemptions and additional investments.

AIMA, Chatham, and State Street also noted that there are limited benefits to including a requirement to "look-through" non-U.S. CIVs to identify and track U.S. beneficial owners of such vehicles. AIMA stated that it is reasonable to assume that the potential investment losses to which U.S. investors in CIVs are exposed are limited to their initial capital investment. Chatham stated that the composition of a CIV's beneficial owners is not likely to have a significant bearing on the degree of risk that the CIV's swap activity poses to the U.S. financial system, noting that CIVs organized or having a

[128] Proposed Rule, 85 FR at 969.

[129] JFMC/IBAJ also requested that conforming amendments be made to the "U.S. person" definition under the Cross-Border Margin Rule. However, this comment is outside of the scope of the Final Rule.

principal place of business in the U.S. would be under the Commission's authority, and majority-owned CIVs may be subject to margin requirements in foreign jurisdictions.

AIMA added that the definition of "U.S. person" in the Guidance is problematic for certain funds managed by investment managers because they are subject to European rules on clearing, margining, and risk mitigation.

After consideration of the comments, and consistent with the definition of "U.S. person" in the Cross-Border Margin Rule and the SEC Cross-Border Rule, the Commission is adopting as proposed a "U.S. person" definition that does not include a commodity pool, pooled account, investment fund, or other CIV that is majority-owned by one or more U.S. persons.[130] 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 Final Rule would likely cause more CIVs to incur additional programmatic costs associated 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.[131] Although many of these CIVs have U.S. participants that could be adversely affected in the event of a counterparty default, systemic risk concerns are mitigated to the extent these CIVs are 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

[130] *See* Cross-Border Margin Rule, 81 FR at 34824; SEC Cross-Border Rule, 79 FR at 47311, 47337.

[131] Proposed Rule, 85 FR at 961. *See* SEC Cross-Border Rule, 79 FR at 47337.

participant in a CIV would make counterparties whole in the event of a default.[132] Further, the Commission continues to believe that identifying and tracking a CIV's beneficial ownership may pose a significant challenge, particularly in certain circumstances such as fund-of-funds or master-feeder structures.[133] Therefore, although the U.S. participants in such CIVs may be adversely affected in the event of a counterparty default, the Commission has determined that the majority-ownership test should not be included in the definition of "U.S. person."

A CIV fitting within the majority U.S. ownership prong may also be a U.S. person within the scope of § 23.23(a)(23)(i)(B) of the Final 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 non-U.S. persons and not offered to U.S. persons is not relevant in determining whether it falls within the scope of the "U.S. person" definition.[134]

(vi) Exclusion of Catch-All Prong

Unlike the non-exhaustive "U.S. person" definition provided in the Guidance,[135] the Commission proposed that the definition of "U.S. person" be limited to persons enumerated in the rule, consistent with the Cross-Border Margin Rule and the SEC Cross-Border Rule.[136] The Commission invited comment on whether the "U.S. person" definition should include a catch-all provision.[137]

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[132] Proposed Rule, 85 FR at 961; SEC Cross-Border Rule, 79 FR at 47311.

[133] *See* Cross-Border Margin Rule, 81 FR at 34824.

[134] *Id.* at 34824 n.62.

[135] *See* Guidance, 78 FR at 45316.

[136] Proposed Rule, 85 FR at 961. *See* 17 CFR 23.160(a)(10); 17 CFR 240.3a71-3(a)(4); Cross-Border Margin Rule, 81 FR at 34824.

AFEX/GPS, Chatham, IIB/SIFMA, and JBA supported elimination of the "include, but not limited to" language from the Guidance. AFEX/GPS stated that this approach should help facilitate compliance with Commission rules. Chatham stated that the catch-all prong works against the core purposes of the cross-border rules, to enhance regulatory cooperation and transparency. IIB/SIFMA stated that market participants have lacked any practical way to delineate the scope of that catch-all phrase, leading to legal uncertainty. JBA stated that the provision is difficult to interpret and leads to uncertainty, and potentially reduced transactions by market participants, leading to increased bifurcation in the market.

The Commission is adopting this aspect of the "U.S. person" definition as proposed.[138] Unlike the non-exhaustive "U.S. person" definition provided in the Guidance, the 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.[139] The Commission believes that the prongs adopted in the Final Rule capture those persons with sufficient jurisdictional nexus to the U.S. financial system and commerce in the United States that they should be categorized as "U.S. persons."[140]

3. Principal Place of Business

The Commission proposed to define "principal place of business" as the location from which the officers, partners, or managers of the legal person primarily direct,

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137 Proposed Rule, 85 FR at 969.

138 *Id.* at 961.

139 *See* 17 CFR 23.160(a)(10); 17 CFR 240.3a71-3(a)(4); 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).

140 Proposed Rule, 85 FR at 961.

control, and coordinate the activities of the legal person, consistent with the SEC definition of "U.S. person."[141] Additionally, with respect to a CIV, the Proposed Rule stated that this location is the office from which the manager of the CIV primarily directs, controls, and coordinates the investment activities of the CIV, and noted 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 would not 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.[142] The Commission invited comment on whether, when determining the principal place of business for a CIV, the Commission should 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.[143]

AIMA supported the proposed definition of "principal place of business" and stated that there are more relevant indicia of U.S. nexus than the activities of forming and promoting a CIV, such as the location of staff who control the investment activities of the CIV. Similarly, IIB/SIFMA supported adopting the SEC's "principal place of business" test for CIVs because it better captures business reality by focusing more on investment strategy rather than the location of promoters who do not have an ongoing responsibility for the vehicle.

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[141] Proposed § 23.23(a)(22)(ii); Proposed Rule, 85 FR at 960, 1003. *See* 17 CFR 240.3a71–3(a)(4)(ii).

[142] Proposed Rule, 85 FR at 960.

[143] *Id.* at 969.

The Commission is adopting the "principal place of business" aspect of the "U.S. person" definition as proposed.[144] As noted in the Cross-Border Margin Rule,[145] and consistent with the SEC definition of "U.S. person,"[146] § 23.23(a)(23)(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 corresponds to the location of the person's headquarters or main office. However, the Commission believes that a definition that focuses exclusively on whether 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 Final Rule.[147]

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[144] Final § 23.23(a)(23)(ii).

[145] Cross-Border Margin Rule, 81 FR at 34823.

[146] 17 CFR 240.3a71–3(a)(4)(ii).

[147] *See* Proposed Rule, 85 FR at 960; SEC Cross-Border Rule, 79 FR at 47309.

However, determining the principal place of business of a CIV, such as an investment fund or commodity pool, may require consideration of additional factors beyond those applicable to operating companies.[148] The Commission interprets that, for 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.[149] 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 corporation's activities."[150] 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 CPO. Therefore, consistent with the SEC Cross-Border Rule,[151] 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 Final Rule is the location from which the manager carries out those responsibilities.

Under the Cross-Border Margin Rule,[152] the Commission generally considers 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

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[148] Proposed Rule, 85 FR at 960.

[149] Final § 23.23(a)(23)(ii).

[150] 559 U.S. 77, 80 (2010). *See* Proposed Rule, 85 FR at 960; Cross-Border Margin Rule, 81 FR at 34823.

[151] *See* SEC Cross-Border Rule, 79 FR at 47310-47311.

[152] Cross-Border Margin Rule, 81 FR at 34823.

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 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.[153] The Commission may also consider amending the "U.S. person" definition in the Cross-Border Margin Rule in the future.

4. Exception for International Financial Institutions

The Commission proposed that, in consideration of the discretionary and appropriate exercise of international comity-based doctrines, the term "U.S. person" would not include certain multilateral and other international financial institutions.[154]

IIB/SIFMA supported the proposed exception for certain international financial institutions, noting that the Commission has routinely recognized the special status afforded these institutions under the traditions of the international system by effectively treating them as non-U.S. persons for most purposes, and it is therefore appropriate for the Commission to codify this treatment through this exception. IIB/SIFMA also stated that the catch-all for "similar international organizations" appropriately addresses the international comity considerations that underlie this exception.

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[153] Proposed Rule, 85 FR at 960.

[154] Proposed § 23.23(a)(22)(iii); Proposed Rule, 85 FR at 961-962, 1003.

The Commission is adopting this aspect of the "U.S. person" definition as proposed, with a technical modification as discussed below.[155] Consistent with the SEC's definition,[156] 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, and their agencies and pension plans. The Commission believes that although such 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 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 definition apply.[157] 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."

Consistent with the Entities Rule and the Guidance, the Commission interprets the term "international financial institutions" to include 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

[155] Final § 23.23(a)(23)(iii).

[156] *See* 17 CFR 240.3a71-3(a)(4)(iii).

[157] Proposed Rule, 85 FR at 961-962. *See, e.g.*, Entities Rule, 77 FR at 30692-30693 (discussing the application of the "swap dealer" and "major swap participant" definitions to foreign governments, foreign central banks, and international financial institutions). *See also* Guidance, 78 FR at 45353 n.531.

derivatives, central counterparties and trade repositories."[158] Reference to 22 U.S.C. 262r(c)(2) and the European Union definition is consistent with Commission precedent in the Entities Rule.[159] 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.[160] This prong also includes institutions identified in CFTC Staff Letters 17-34[161] and 18-13.[162] In CFTC Staff Letter 17-34, Commission staff provided relief from CFTC margin requirements to swaps between SDs and the European Stability Mechanism ("ESM"),[163] 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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[158] 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.

[159] Entities Rule, 77 FR at 30692 n.1180. The Guidance referenced the Entities Rule's interpretation as well. Guidance, 78 FR at 45353 n.531.

[160] 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.

[161] *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

institution for purposes of applying the SD and MSP definitions.[164] 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 Final Rule lists specific international financial institutions but also provides a catch-all for "any other similar international organizations, and their agencies and pension plans." As a technical edit, the Commission notes that the catch-all for international financial institutions in the Final Rule now includes "and" in the clause "*and* their agencies and pension plans." The catch-all provision extends to any of the entities discussed above that are not explicitly listed in the Final Rule.[165]

5. Reliance on Prior Representations

As noted above in section II.A, the Final Rule states that a person may rely on a written representation from its counterparty that the counterparty does or does not satisfy

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Position with Respect to Uncleared Swaps with the European Stability Mechanism (Oct. 16, 2019), available at https://www.cftc.gov/csl/19-22/download.

[162] *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.

[163] *See* CFTC Staff Letter No. 17-34. In addition, in May 2020, the Commission adopted an amendment to § 23.151 to exclude ESM from the definition of "financial end user," which will 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, 85 FR 27674 (May 11, 2020).

[164] *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.

[165] Proposed Rule, 85 FR at 962.

the criteria for one or more of the definitions, unless such person knows or has reason to know that the representation is not accurate.[166]

Further, with respect to the "U.S. person" definition, to provide certainty to market participants, the Commission proposed to permit reliance, until December 31, 2025, on any U.S. person-related representations that were obtained to comply with the Cross-Border Margin Rule.[167] The Commission also stated that any person designated as a "U.S. person" under the Proposed Rule would also be a "U.S. person" under the Guidance, and therefore, market participants would also be able to rely on representations previously obtained under the "U.S. person" definition in the Guidance.[168]

IIB/SIFMA and State Street recommended that the reliance on U.S. person representations made with respect to the Cross-Border Margin Rule should be permitted on a permanent basis. State Street asserted that permanent relief raises no new policy considerations, eliminates a "cliff effect" in 2025, and eliminates the potential need for market participants to seek Commission extension of the 2025 deadline should circumstances arise where seeking new representations is impractical or unduly burdensome. Additionally, IIB/SIFMA, ISDA, JFMC/IBAJ, and State Street stated that reliance should explicitly be permitted with respect to representations made pursuant to the Guidance. JFMC/IBAJ stated that this would be appropriate given the compliance burdens associated with obtaining representations. State Street noted that the Commission would increase clarity and market efficiency by explicitly providing for Guidance-related representations in final rule text.

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[166] Final § 23.23(a).

[167] Proposed § 23.23(a)(22)(iv); Proposed Rule, 85 FR at 962, 1003.

[168] Proposed Rule, 85 FR at 962.

In response to these comments, the Commission notes that it proposed temporary reliance on prior representations in the Proposed Rule because it assumed that SDs and MSPs somewhat routinely amend swap trading relationship documentation and thus updated representations based on the proposed U.S. person definition could be obtained in the course of these routine amendments. Permitting temporary reliance to facilitate this method of updating representations is less burdensome and more cost efficient than requiring all affected SDs and MSPs to update representations within a relatively brief compliance period. The Commission has determined that permanent reliance on representations obtained under the Guidance or the Cross-Border Margin Rule would be contrary to good recordkeeping practices, particularly for dormant relationships, which require updated representations within a set time period. Additionally, there are a variety of circumstances that routinely lead SDs and MSPs to amend counterparty trading relationship documentation, such as address changes, payment detail updates, ISDA definition changes, and LIBOR amendments.

To relieve concerns that the December 31, 2025 deadline is burdensome, the Commission is adopting an approximately seven year time limit, until December 31, 2027, for reliance on "U.S. person" representations made pursuant to the Cross-Border Margin Rule, instead of the five year limit that was proposed.[169] Thus, for those counterparties for whom a person has already obtained U.S. person-related representations under the Cross-Border Margin Rule, U.S. person-related representations under the Final Rule will only be required from those counterparties with whom swaps

[169] Final § 23.23(a)(23)(iv).

are entered after December 31, 2027. Nevertheless, best practice is to obtain updated representations as soon as practicable.

In addition, the Commission has adjusted the rule text of § 23.23(a)(23)(iv) to clarify that reliance is only permitted for representations obtained prior to the effective date of the Final Rule.[170] Persons should not be permitted to rely on representations obtained pursuant to the Cross-Border Margin Rule after the effective date of the Final Rule when such persons could have also obtained representations pursuant to the Final Rule contemporaneously therewith.

The Commission reiterates that it believes that any person designated as a "U.S. person" under the Final Rule is also a "U.S. person" under the Guidance definition, as the Final Rule's definition is narrower in scope. Therefore, the Commission is of the view that market participants may also rely on representations previously obtained using the "U.S. person" definition in the Guidance.[171] A representation obtained under the Guidance should not be relied on permanently, and new representations should be obtained as soon as practicable, but in the Commission's view it would not be appropriate to rely on representations under the Guidance after the December 31, 2027 deadline for similar representations made under the Cross-Border Margin Rule. Thus, for those counterparties for whom a person has already obtained U.S. person-related representations under the Guidance, U.S. person-related representations under the Final Rule will only be required from those counterparties with whom swaps are entered after December 31, 2027.

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[170] Final § 23.23(a)(23)(iv)(A).

[171] Proposed Rule, 85 FR at 962.

In response to commenters, the Commission has determined to add rule text permitting reliance on representations obtained under the Guidance.[172] The Commission understands that while the Guidance is non-binding, many market participants have chosen to develop policies and practices that take into account the views expressed therein, including expending time and resources to classify counterparties in accordance with the interpretation of the term "U.S. person" as set forth in the Guidance. Adding rule text permitting reliance on representations obtained under the Guidance recognizes, and should reduce, the practical burdens of compliance with the Final Rule by enhancing regulatory certainty.

Finally, the rule text of § 23.23(a)(23)(iv)(B) clarifies that reliance is only permitted for representations obtained prior to the effective date of the Final Rule. As with U.S. person-related representations obtained pursuant to the Cross-Border Margin Rule, persons should not be permitted to rely on representations obtained pursuant to the Guidance after the effective date of the Final Rule when such persons could have also obtained representations pursuant to the Final Rule contemporaneously therewith.

6. Other

The Commission considers the following comments in connection with the proposed "U.S. person" definition beyond the scope of this rulemaking and is not addressing them in the Final Rule. However, the Commission takes these comments under advisement for any relevant future Commission action.

AIMA encouraged the CFTC to use the proposed "U.S. person" definition universally across all Title VII requirements and the CEA, including in part 4 for CPOs,

[172] Final § 23.23(a)(23)(iv)(B).

commodity pools, and commodity trading advisors ("CTAs"). CS encouraged further harmonization of the "U.S. person" definition, to the extent possible, within the context of SD activity, including the CFTC's capital and margin rules. IIB/SIFMA recommended making conforming changes to the "U.S. person" definition under the Cross-Border Margin Rule to avoid the confusion that will arise from using different definitions of the same term in a single, comprehensive regulatory regime. Finally, JFMC/IBAJ and JSCC requested that the Commission specify that the "U.S. person" definition would also apply to, and supersede, the definition referenced in the CFTC's Orders of Exemption from Registration granted to the Japan Securities Clearing Corporation.[173]

C. Guarantee

1. Proposed Rule

The Commission proposed defining "guarantee" as 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.[174] For these purposes, a party to a swap would have 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. Also, the term "guarantee" would encompass any arrangement pursuant to which the guarantor itself has a conditional or unconditional legally enforceable right to receive

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[173] *See* Amended Order of Exemption from Registration issued for JSCC (May 15, 2017), available at https://www.cftc.gov/idc/groups/public/@otherif/documents/ifdocs/jsccdcoexemptamdorder5-15-17.pdf.

[174] Proposed § 23.23(a)(8); Proposed Rule, 85 FR at 963-64, 1002-03.

or otherwise collect, in whole or in part, payments from any other guarantor with respect to the counterparty's obligations under the swap.

2. Summary of Comments

In general, AFEX/GPS, Chatham, IIB/SIFMA, and JFMC/IBAJ supported the proposed "guarantee" definition, while AFR, Barnard, and Better Markets opposed the proposed definition.

AFEX/GPS, Chatham, and JFMC/IBAJ supported the consistency of the proposed definition with the definition in the Cross-Border Margin Rule. JFMC/IBAJ also supported the consistency with the SEC Cross-Border Rule. AFEX/GPS and Chatham noted that the consistency would make the definition more workable.

AFEX/GPS stated that using the broad and vague definition of guarantee in the Guidance, which includes consideration of "facts and circumstances" and a non-exclusive list of examples, would not be appropriate, while the proposed definition would be objective and should facilitate compliance without sacrificing concerns about systemic risk flowing back to the United States. Chatham stated that the proposed definition would provide greater legal certainty around what is considered to be a guarantee and focuses the Commission's authority on potential significant risks to the U.S. financial system. IIB/SIFMA noted that the proposed definition would promote legal certainty by establishing a clearer test for when a non-U.S. person is considered to have financial support from a U.S. person, eliminating coverage of certain risk-shifting arrangements (*e.g.*, keepwells and liquidity puts) that do not provide a non-U.S. person's counterparty with recourse against a U.S. guarantor. IIB/SIFMA added that to the extent a firm uses the unlimited U.S. responsibility structure (discussed in section II.B.2.iv above), the

Commission could sufficiently address the resulting risks to the United States by treating the firm as having a guarantee from a U.S. person, as the SEC does, rather than considering such an entity a U.S. person. JFMC/IBAJ stated that the definition under the Guidance introduced compliance challenges to market participants globally, including difficulties in confirming or obtaining representations from counterparties regarding whether certain arrangements, particularly purely internal arrangements within a counterparty's corporate group, constituted a "guarantee." JFMC/IBAJ also supported the clarification that a non-U.S. person would be considered a "guaranteed entity," as described below, only with respect to swaps that are guaranteed by a U.S. person.

ISDA, IIB/SIFMA, JFMC/IBAJ, and State Street also recommended that the Commission permit reliance on guarantee-related representations received pursuant to the Cross-Border Margin Rule and Guidance, analogous to the Proposed Rule and related comments with respect to the "U.S. person" definition, discussed above. IIB/SIFMA and State Street stated that such reliance should not be time limited.

AFR asserted that the narrower definition of guarantee, as compared to the Guidance, would permit numerous informal or even formal forms of guarantees between U.S. parent corporations and their subsidiaries to escape the definition. Barnard stated that the narrower definition would allow significant risk to be transferred back to the U.S. financial system over time. Barnard noted that economic implications are just as important as legal considerations, as confirmed and intended by CEA section 2(i)(1). Similarly, Better Markets recommended that the Commission revise its proposed definition of "guarantee" to include all forms of U.S. financial support used to facilitate dealing through non-U.S. affiliates because financial arrangements posing potential risks to U.S. persons and the U.S. financial system include more than solely contractual guarantees contained in swap trading relationship documentation between non-U.S. counterparties.

Better Markets added that a narrower definition of "guarantee" would elevate form over substance and have possible significant adverse effects on the U.S. financial system. Better Markets did not agree that a definition posing possible significant adverse effects on the U.S. financial system nevertheless should be adopted, merely because the proposed "guarantee" definition mirrors the definition in the Cross-Border Margin Rule and therefore would not demand "a separate independent assessment." Better Markets asserted that it is neither a valid statutory purpose nor a benefit that outweighs, or even reasonably approximates, its costs. Better Markets added that CEA section 5(b) and related provisions make clear that the CFTC's core statutory policy objectives are to protect the safety and soundness of SDs, prevent disruptions to the integrity of derivatives markets, ensure the financial integrity of swaps transactions and the avoidance of systemic risk, and preserve the stability of the U.S. financial system.

Better Markets also stated that the CFTC's use of the margin-related "guarantee" definition is not appropriate. Its view was that margin requirements on uncleared swaps are market and credit risk mitigants that are imposed on specific portfolios of derivatives with specific counterparties, while the proposed definition would address broader systemic risk reduction and other policy objectives, including statutory concerns about the evasion of U.S. law through legal entity booking strategies. Further, Better Markets asserted that the narrower definition would increase risks to U.S. persons, because the definition would result in fewer swaps transactions being treated as "guaranteed," opening a loophole for dealing conducted through unregistered affiliates of U.S. banks that nevertheless benefit from direct U.S. financial support.

3. Final Rule

After carefully considering the comments received, the Commission is adopting the definition of "guarantee" as proposed, with certain modifications and clarifications as discussed below.[175]

Consistent with the Cross-Border Margin Rule, the term "guarantee" applies regardless of whether the 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.[176] The terms of the guarantee need not necessarily be included within the swap documentation or even otherwise reduced to writing, provided that, under the laws of the relevant jurisdiction, 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 Final Rule, the Commission generally considers swap activities involving guarantees from U.S. persons to satisfy the "direct and significant" test under CEA section 2(i).[177]

However, in contrast to the Cross-Border Margin Rule and the Proposed Rule, but consistent with the recommendation by IIB/SIFMA, the Commission is interpreting

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[175] Final § 23.23(a)(9).

[176] Proposed Rule, 85 FR at 963-64. *See* 17 CFR 23.160(a)(2); Cross-Border Margin Rule, 81 FR at 34825.

[177] Proposed Rule, 85 FR at 963.

"guarantee" in a manner similar to the SEC, specifically with respect to the unlimited U.S. responsibility prong. Similar to the SEC, 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 swap by virtue of the U.S. person's unlimited responsibility for the non-U.S. person, such an arrangement is considered a guarantee, and as discussed in sections III.B.3.i and IV.B.3.i below, the non-U.S. person is required to include the swap in its SD and MSP threshold calculations, respectively.[178] As noted above, the Commission is not including the unlimited U.S. responsibility prong in the "U.S. person" definition, but interprets such relationships as guarantees to ensure they are appropriately covered by the Final Rule.

The term "guarantee" also encompasses 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. This addresses concerns that swaps could be structured such that they would not count toward a non-U.S. person's threshold calculations. 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 definition of "guarantee" deems a guarantee to exist between Party B and Parent D with respect to Party B's obligations under the swap with Party A.[179]

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[178] *See* SEC Cross-Border Rule, 79 FR at 47316-47317, 47344.

[179] Proposed Rule, 85 FR at 963. *See* Cross-Border Margin Rule, 81 FR at 34825.

The Commission's definition of guarantee is not affected by whether the U.S. guarantor is an affiliate of the non-U.S. person because, 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.

Also, the "guarantee" definition does 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 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 does not exist because Party F does 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).[180]

As with the Cross-Border Margin Rule, the definition of "guarantee" in the Final Rule is narrower in scope than the one used in the Guidance.[181] 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

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[180] Proposed Rule, 85 FR at 963. *See* Cross-Border Margin Rule, 81 FR at 34825.

[181] *See* Cross-Border Margin Rule, 81 FR at 34824.

financial arrangements and structures that transfer risk directly back to the United States.[182] The Commission is aware that many other types of financial arrangements or support, other than a guarantee as defined in the Final 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 adverse effects, in a manner similar to a guarantee with a direct recourse to a U.S. person. However, the Commission has determined that a narrower definition of guarantee than that in the Guidance achieves a more workable framework for non-U.S. persons, particularly because the Final Rule's definition of "guarantee" is consistent with the Cross-Border Margin Rule, and therefore does not require a separate independent assessment, without undermining the protection of U.S. persons and the U.S. financial system. The Commission is sympathetic to comments regarding, and is independently aware of, the difficulty in confirming or obtaining representations from counterparties regarding whether certain arrangements, particularly purely internal arrangements within a counterparty's corporate group, constitute a "guarantee." However, such difficulty does not extend to classifying as guarantees arrangements that provide a non-U.S. person's counterparty with recourse to a U.S. person for the performance of the non-U.S. person's obligations under a swap.

A broad definition of guarantee, as recommended by AFR, Barnard, and Better Markets, would make it difficult for certain entities to determine whether their counterparty is guaranteed or not. General consistency with the Cross-Border Margin

[182] Guidance, 78 FR at 45320.

Rule definition means no additional burden for market participants. Additionally, though the definition of "guarantee" in the Guidance was broader, having a specific standard in a rule is preferable to an open-ended interpretation. The Commission recognizes that the definition of "guarantee" could lead to certain entities counting fewer swaps towards their SD or MSP thresholds or qualify additional counterparties for exceptions to certain regulatory requirements as compared to the definition in the Guidance. However, such concerns could be mitigated to the extent such non-U.S. persons meet the definition of a "significant risk subsidiary," and thus, as discussed below, are required to count certain swaps or swap positions toward their SD or MSP registration thresholds. In this way, non-U.S. persons receiving support from a U.S. person and representing a significant risk to the U.S. financial system are captured by the Final Rule. Accordingly, the Final Rule achieves the dual goals of protecting the U.S. markets and promoting a workable cross-border framework.

In response to comments, the Commission is adopting language in the "guarantee" definition that is parallel to the language for "U.S. persons," allowing persons to rely on counterparty representations with respect to a counterparty's "guarantee" status obtained pursuant to the Cross-Border Margin Rule. As discussed above, permitting temporary reliance to facilitate this method of updating representations is less burdensome and more cost efficient than requiring all affected SDs to update representations within a relatively brief compliance period. However, permanent reliance on representations obtained under the Guidance or the Cross-Border Margin Rule would be inconsistent with good recordkeeping practices, particularly for dormant relationships, thus, the Commission has determined to require an updated representation within a set time period. The Commission is thus adopting an approximately seven year time limit, until December 31, 2027, on counterparty representations with respect to a counterparty's "guarantee" status obtained pursuant to the Cross-Border Margin Rule, the same as is permitted for reliance on the "U.S. person" representations. Thus, for those counterparties for whom a person has already obtained guarantee-related representations under the Cross-Border Margin Rule, guarantee-related representations under the Final Rule will only be required from those counterparties with whom swaps are entered after December 31, 2027. Nevertheless, best practice is to obtain updated representations as soon as practicable.

In addition, the Commission has adjusted the rule text of § 23.23(a)(9) to clarify that reliance is only permitted for representations obtained prior to the effective date of the Final Rule.[183] Persons should not be permitted to rely on representations obtained pursuant to the Cross-Border Margin Rule after the effective date of the Final Rule when such persons could have also obtained representations pursuant to the Final Rule contemporaneously therewith.

The Commission believes that any "guarantee" related representation received under the Guidance definition would also apply under the Final Rule, as the Final Rule's definition is generally narrower in scope. Therefore, the Commission is of the view that market participants may also rely on representations previously obtained using the "guarantee" definition in the Guidance.[184] Nevertheless, a representation obtained under

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[183] Final § 23.23(a)(9)(i).

[184] An SD or MSP may not rely on a representation obtained for purposes of the Guidance that a counterparty's swaps are not guaranteed by a U.S. person if the SD or MSP has classified the counterparty as a U.S. person under the unlimited U.S. responsibility prong of the U.S. person definition in the Guidance.

the Guidance should not be relied on permanently and should be obtained as soon as practicable, but in the Commission's view it would not be appropriate to rely on representations under the Guidance after the December 31, 2027 deadline for similar representations made under the Cross-Border Margin Rule. Thus, for those counterparties for whom a person has already obtained guarantee-related representations under the Guidance, guarantee-related representations under the Final Rule will only be required from those counterparties with whom swaps are entered after December 31, 2027.

In response to commenters, the Commission has determined to add rule text permitting reliance on representations obtained under the Guidance.[185] The Commission understands that while the Guidance is non-binding, many market participants have chosen to develop policies and practices that take into account the views expressed therein, including expending time and resources to classify counterparties in accordance with the interpretation of the term "guarantee" as set forth in the Guidance. Adding rule text permitting reliance on representations obtained under the Guidance recognizes, and should reduce, the practical burdens of compliance with the Final Rule by enhancing regulatory certainty.

Finally, the rule text of § 23.23(a)(9)(ii) clarifies that reliance is only permitted for representations obtained prior to the effective date of the Final Rule. As with guarantee-related representations obtained pursuant to the Cross-Border Margin Rule, persons should not be permitted to rely on representations obtained pursuant to the

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[185] Final § 23.23(a)(9)(ii).

Guidance after the effective date of the Final Rule when such persons could have also obtained representations pursuant to the Final Rule contemporaneously therewith.

For ease of understanding, the discussion in this release uses the term "Guaranteed Entity" to refer to a non-U.S. person whose swaps are guaranteed by a U.S. person, but only with respect to the swaps that are so guaranteed. Thus, a non-U.S. person may be a Guaranteed Entity with respect to its 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 its 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.

Additionally, 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 (as defined below).[186] Depending on an entity's corporate structure and financial relationships, a single entity could be both a Guaranteed Entity and a significant risk subsidiary and, as noted above, it may be a Guaranteed Entity for certain of its swaps and an Other Non-U.S. Person for others.

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

1. Proposed Rule

The Commission proposed a new category of entity termed a significant risk subsidiary ("SRS"). Under the Proposed Rule, a non-U.S. person would be considered an

[186] Note that an Other Non-U.S. Person can include a registered SD or MSP.

SRS if: (1) the non-U.S. person is a "significant subsidiary" of an "ultimate U.S. parent entity," as those terms were 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. generally accepted accounting principles ("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.[187] If an entity is determined to be an SRS, the Commission proposed to apply certain regulations to the entity in the same manner as a U.S. person in some instances, for example in the application of the SD and MSP registration threshold calculations, and in the same manner as a Guaranteed Entity in other instances, for example in the application of group B and C requirements.

With respect to conduit affiliates, the Guidance included a discussion of factors that would be taken into account when determining whether an entity was a conduit affiliate of a U.S. person. The Proposed Rule stated that this concept was not being included in the proposed regulations because the concerns posed by a conduit affiliate were intended to be addressed through the proposed definition and regulation of SRSs.

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[187] Proposed Rule, 85 FR at 964-968.

2. Summary of Comments

In the Proposed Rule, the Commission asked whether it should use the concept of a conduit affiliate, as was done in the Guidance, in order to harmonize with the SEC.[188] AEFX/GPS, Chatham, JFMC/IBAJ, and IIB/SIFMA all stated that they prefer the SRS entity definition to the use of the conduit affiliate concept from the Guidance. AFEX/GPS, Chatham, and IIB/SIFMA stated that the objective criteria in the SRS definition are preferable to the conduit affiliate concept in the Guidance, which is more difficult to apply. JFMC/IBAJ and IIB/SIFMA also commented that the SRS definition is an improvement over the FCS concept previously proposed in the 2016 Proposal because the SRS definition excludes those subsidiaries that are not significant to their parent entities. Better Markets stated that the proposed SRS definition does not address the avoidance and evasion risks addressed by the conduit affiliate concept in the Guidance. IATP suggested that the previously proposed FCS concept be retained in place of the SRS definition. JBA stated that market participants have already assessed, under the Guidance, whether their activities are subject to the swap rules based on the attributes of their counterparties and requiring them to re-assess will create significant burdens on market participants. ISDA suggested that with respect to SRSs, entities should be permitted to rely on counterparty representations pertaining to conduit affiliates as described in the Guidance.

CS and IIB/SIFMA stated that the exclusion for subsidiaries of BHCs in the SRS definition should be expanded to include those entities that are subsidiaries of intermediate holding companies ("IHCs"). These commenters noted that IHCs are

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[188] Proposed Rule, 85 FR at 969-970.

subject to prudential regulation, including Basel III capital requirements, stress testing, liquidity, and risk management requirements.

JFMC/IBAJ and IIB/SIFMA suggested that accounting consolidation does not create a sufficient jurisdictional nexus to the United States because there is no requirement that the U.S. entity be directly liable for the foreign subsidiary's swaps. These commenters stated that if the SRS definition is nevertheless retained then the proposed significance tests should also be retained. IIB/SIFMA and the Working Group stated that the definition of ultimate U.S. parent entity should be limited to those groups of entities where the top-tier ultimate parent company is a U.S. person.

With respect to the exception in § 23.23(a)(13)(i) for subsidiaries of BHCs, AFR and Better Markets stated that the Commission should eliminate this exception because deference to the prudential regulators in this way is not justified. AFR noted the failure of prudential supervision of banks to adequately address derivatives markets risks prior to the 2008 financial crisis. IATP, AFR, and Barnard stated that the broad exemptions would exclude almost all foreign subsidiaries of U.S. companies and be a significant reduction in the application of the Commission's swap regulations. Better Markets stated that the Commission does not have the discretion to determine whether and when to apply U.S. regulatory requirements based on principles of international comity when there is a direct and significant risk to U.S. BHCs and the U.S. financial system.

Better Markets suggested that if the SRS definition is retained then there should be two additional significance tests added to those in § 23.23(a)(14). This commenter proposed that if an entity were to meet a risk transfer test, measuring the notional amount of swaps that are back-to-backed with U.S. entities, or a risk acceptance test, measuring the trading activity of the subsidiary over a three month time period, then the entity would be considered a significant subsidiary.

The Working Group suggested that the proposed SRS definition should be modified to limit the applicability to only those entities that qualify as financial entities because the systemic risk associated with non-financial entities is mitigated because their activities primarily take place outside of the financial system. The Working Group agreed with the Commission's proposal to exclude from the SRS definition those entities that are subject to oversight by the non-U.S. person's home country regulator and capital standards consistent with Basel III. However, the commenter added that to the extent a regulator has exempted a particular type of entity from capital requirements otherwise consistent with Basel III, the CFTC should defer to such exemption and consider such entity as subject to comparable capital requirements.

3. Final Rule and Commission Response

The Commission is adopting the SRS definition as proposed, with two modifications as discussed below. First, the Final Rule adds IHCs to the exclusion in § 23.23(a)(13)(i) for those companies that are subject to consolidated supervision and regulation by the Federal Reserve Board. Second, with respect to the carve-out in § 23.23(a)(13)(ii), the Final Rule makes a clarifying revision to the margin requirements aspect of that provision.

(i) Non-U.S. Persons with U.S. Parent Entities

As discussed in the Proposed Rule, in addition to the U.S. persons described above in section II.B, 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.[189] 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. This risk, in the aggregate, may have a significant effect on the U.S. financial system. Therefore, the Commission may subject consolidated non-U.S. subsidiaries of U.S. persons to Commission regulation due to their direct and significant relationship to their U.S. parent entities. Further, 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.[190] Moreover, because U.S. persons have regulatory obligations under the CEA that Other Non-U.S. Persons may not have, 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 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

[189] Proposed Rule, 85 FR at 964.

[190] 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 an SRS.

direct risk to the U.S. parent.[191] 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, 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, 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 effect 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.

IIB/SIFMA and JFMC/IBAJ stated that there is no legal basis to apply swap regulations based on accounting consolidation. The Commission continues to believe, as it stated in its Cross-Border Margin Rule, by virtue of an entity having its financial statements consolidated with those of its U.S. ultimate parent, the financial position, operating results, and statement of cash flows of the entity are included in the financial statements of its U.S. ultimate parent entity and therefore affect the financial position,

[191] Proposed Rule, 85 FR at 964.

risk profile, and market value of the U.S. ultimate parent. Because of the entity's direct relationship with, and the possible negative effect of its swap activities on, its U.S. ultimate parent entity and the U.S. financial system, the entity raises greater supervisory concern in the United States relative to other non-U.S. swap entities.[192] Accordingly, it is appropriate to apply certain swap regulations to certain entities that have financial statements consolidated with U.S. parent entities.

However, the principles of international comity militate against applying the Commission's swap regulations to all non-U.S. subsidiaries of U.S. parent entities. Rather, 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's approach in the Final Rule, as discussed further below with respect to the exclusion for subsidiaries of BHCs and IHCs, 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 operate efficiently outside the United States. The Commission's risk-based approach is embodied in the definition of an SRS, which, as discussed above, captures entities whose obligations under swaps may not be guaranteed by U.S. persons, but nonetheless raise particular supervisory concerns in the United States due to the possible negative effect on their ultimate U.S. parent entities and thus the U.S. financial system.

(ii) Preliminary Definitions

For purposes of the SRS definition, the term "subsidiary" means an affiliate of a person controlled by such person directly, or indirectly through one or more

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[192] *See* Cross-Border Margin Rule, 81 FR at 34827.

intermediaries.[193] The definition of "subsidiary" has been revised in the Final Rule for clarity. 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.[194] In the Final Rule, the definition of "affiliate" has been moved out of the definition of "subsidiary" and into its own definition for added clarity, since the term "affiliate" is relevant for other provisions of the Final Rule, as discussed in this release. The term "control," including 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.[195] The definition of "control" is also relevant to other provisions of the Final Rule, as discussed in this release. The definitions of subsidiary, affiliate, and control are substantially similar to the definitions found in SEC Regulation S-X.[196] Further, under the Final Rule, the term "parent entity" means 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.[197] U.S. GAAP is defined in the Final Rule as U.S. generally accepted accounting principles.[198]

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[193] Final § 23.23(a)(15).

[194] Final § 23.23(a)(1).

[195] Final § 23.23(a)(2).

[196] *See* 17 CFR 210.1-02. Regulation S-X generally covers the form and content requirements for financial statements.

[197] Final § 23.23(a)(12).

[198] Final § 23.23(a)(22).

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 encompasses 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 Final 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" is the U.S. parent entity that is not a subsidiary of any other U.S. parent entity.[199] 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, the Commission is basing the SRS definition on whether a non-U.S. person has any U.S. parent entity, subject to certain risk-based thresholds.

IIB/SIFMA and the Working Group stated that the SRS definition should be limited to subsidiaries that have a "top-tier" U.S. person parent entity, rather than including subsidiaries that have a U.S. parent entity that may not be the ultimate parent entity. The Commission is including subsidiaries that have non-"top-tier" U.S. parent entities because the risk that the subsidiary poses may be consolidated in the United States. The Final Rule treats all subsidiaries of U.S. parent entities equally, regardless of where the U.S. parent entity sits in the corporate structure.

(iii) Significant Risk Subsidiaries

In addition to the definitions discussed above, whether an entity is an SRS depends on the size of its ultimate U.S. parent entity, the significance of the subsidiary to

[199] Final § 23.23(a)(19).

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 Final Rule, the ultimate U.S. parent entity must exceed a $50 billion consolidated asset threshold.[200] The Commission is adopting the $50 billion threshold after considering both the Commission's interest in adequately overseeing those non-U.S. persons that may have a significant effect on their ultimate U.S. parent entity – and, by extension – the U.S. financial system, and also its interest in avoiding unnecessary burdens on those non-U.S. persons that would not have such an effect.[201] The $50 billion threshold limits 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 is an SRS, the subsidiary needs 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.[202] The Commission is focusing on only those subsidiaries that are significant to their ultimate U.S. parent entities, in order to capture those subsidiaries that have a significant effect on their large

[200] Final § 23.23(a)(13).

[201] Proposed Rule, 85 FR at 965.

[202] 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).

ultimate U.S. parent entities. To provide certainty to market participants as to what constitutes a significant subsidiary, the Final Rule includes a set of quantitative significance tests. Although not identical, the SEC includes similar revenue and asset significance tests in its definition of significant subsidiary in Regulation S-X.[203] In this case, in order to determine whether a subsidiary meets such significance, the Final Rule measures the significance of a subsidiary's equity capital, revenue, and assets relative to its ultimate U.S. parent entity.

Under the Final Rule, the term "significant subsidiary" means a subsidiary, including its own 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 is 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").[204] For the equity capital significance test, equity capital includes perpetual preferred stock, common stock, capital

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[203] 17 CFR 210.1-02(w)(1)-(3) (setting out a ten percent significance threshold with respect to total assets and income).

[204] Final § 23.23(a)(14).

surplus, retained earnings, accumulated other comprehensive income, and other equity capital components and is calculated in accordance with U.S. GAAP.

The Final Rule results in an entity being a significant subsidiary only if it passes at least one of these significance tests. The equity capital test is used to measure a subsidiary's significance to its ultimate U.S. parent entity and is used in the context of financial statement reporting of foreign subsidiaries.[205] If a subsidiary constitutes more than ten percent of its ultimate U.S. parent entity's assets or revenues, it is of significant importance to its ultimate U.S. parent entity such that swap activity by the subsidiary may have a material effect on its ultimate U.S. parent entity and, consequently, the U.S. financial system. The Commission is using a three year rolling average throughout its significance tests in order to mitigate the potential for frequent changes in an entity's SRS status based on fluctuations in its share of equity capital, revenue, or assets of its ultimate U.S. parent entity. If a subsidiary satisfies any one of the three significance tests, then it is of sufficient significance to its ultimate U.S. parent entity, which under § 23.23(a)(13) has consolidated assets of more than $50 billion, to warrant the application of requirements addressed by the Final Rule if such subsidiary otherwise meets the definition of SRS.

As noted above, Better Markets suggested that the Commission add two activity-based tests to the proposed significant subsidiary definition: a risk transfer test and a risk acceptance test. The Commission declines to include these two tests because they do not consider the risk to the broader financial system of the entities that are potentially captured by the Final Rule. Better Markets' proposed tests are activity-based, rather than

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[205] *See* FR 2314 and FR 2314S Instructions, at Gen-2.

risk-based, whereas the Commission has determined to apply swap requirements to foreign entities using a risk-based test. Better Markets' proposed tests would set thresholds above which an entity would be deemed to be significant subsidiaries, however these tests do not provide any measure that is relative to the parent entity. Such notional-based thresholds may be a measure of activity, but they are not a measure of risk that a subsidiary poses to a parent entity.[206] The significance tests adopted here to identify SRSs include those entities that meet the commenters' proposed tests to the extent those entities pose what the Commission considers a significant risk to the financial system.

(iv) Exclusions from the Definition of SRS

As indicated above, under the Final Rule, a non-U.S. person will not be an SRS to the extent the entity is subject to prudential regulation as a subsidiary of a U.S. BHC or IHC, or is subject to comparable capital and margin standards.[207] An entity that meets either of those two exceptions, in the Commission's view, is subject to a level of regulatory oversight that is sufficiently comparable to the Dodd-Frank Act 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,[208] including with respect to capital and risk management requirements, and

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[206] The Commission also has noted in the past that such notional amount-based thresholds are not measures of the exposure or risk of particular swap positions. *See* Entities Rule, 77 FR at 30630.

[207] Final § 23.23(a)(13)(i)-(ii).

[208] 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 [BHCs] so that, in financing U.S. trade and investments abroad, these U.S. banking organizations can be competitive with institutions of the host

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 not a BHC.[209] In this case, deference to the foreign regulatory regime is 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.

The exclusion from the SRS definition for subsidiaries of IHCs is being added to the Final Rule in response to comments. IHCs are subject to prudential standards of the Federal Reserve Board that are similar to those that apply to BHCs. In general, IHCs and BHCs of similar size are subject to similar liquidity, risk management, stress testing, and credit limit standards.[210] Therefore, for the same risk-based reasons that the Commission proposed to exclude subsidiaries of BHCs from the definition of SRS,[211] the Commission is expanding the SRS exclusion to include subsidiaries of both BHCs and IHCs in § 23.23(a)(13)(i).

In response to comments from AFR and Better Markets that the Commission should not defer to the prudential regulators with respect to the regulation of derivative market activity of BHCs and those entities subject to the required non-U.S. capital and margin regimes, under the Guidance, absent a guarantee, the Commission had generally not expected these entities to count their swaps or swap positions with non-US persons

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country without compromising the safety and soundness of their U.S. operations."); FR 2314 and FR 2314S Instructions, at GEN 2.

[209] Proposed Rule, 85 FR at 966.

[210] *See e.g.*, Prudential Standards for Large Bank Holding Companies, Savings and Loan Holding Companies, and Foreign Banking Organizations, 84 FR 59032 (Nov. 2019).

[211] Proposed Rule, 85 FR at 966.

towards the SD or MSP thresholds or, if registered as swap entities, comply with Transaction-Level Requirements (discussed in section VI below) when transacting with non-U.S. persons that were not guaranteed by a U.S. person nor acting as conduit affiliates. Thus, the deference to U.S. and non-U.S. prudential regulators in the Final Rule maintains the status quo of the last seven years rather than representing a relinquishment of existing regulatory oversight by the Commission. Moreover, the SRS definition does not defer to prudential regulators to regulate derivatives market activity, which is carried on by the foreign subsidiary, but rather defers to the role of prudential regulation in the consolidated oversight of prudential risk in evaluating the extent to which the Commission should expand its oversight of non-U.S. entities that are not guaranteed by a U.S. person beyond the Guidance. For the reasons noted above, the Commission has determined not to apply the Final Rule on the basis of accounting consolidation alone, but rather, in exercising its oversight of non-U.S. entities, has taken a risk-based approach to determining which foreign subsidiaries present a significant risk to their ultimate U.S. parent and thus to the U.S. financial system. The Commission thus has determined that because the risk presented by foreign subsidiaries that are consolidated with a BHC or IHC, or are subject to the specified prudential regulation in their local jurisdiction, is already being adequately monitored, such foreign subsidiaries should not also be subject to the Commission's oversight.

With respect to the BHC exception, Better Markets suggested that the Commission does not have the legal discretion to defer to prudential regulators because of the requirements in CEA section 2(i). As the Commission stated in the Proposed Rule, CEA section 2(i) does not require the Commission to extend its reach to the outer bounds of the authorization provided in CEA section 2(i).[212] In determining how to exercise its authority, the Commission stated that it will be guided by principles of international comity and will focus its authority on potential significant risks to the U.S. financial system. The Commission noted that 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.[213] In the context of the SRS definition, the risk-based approach to limiting the application of the Commission's requirements extraterritorially focuses its requirements on those entities that pose significant risk to the U.S. financial system, as discussed above.

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 will defer to the home country regulator.[214] In cases where entities are subject to capital standards and oversight by home country regulators that are consistent with Basel III and subject to a CFTC Margin Determination, the potential risk that the entity might pose to the U.S. financial system is adequately addressed through these home country capital and margin requirements. Further, such an approach is consistent with the Commission's historical commitment to show deference to non-U.S. regulators whose requirements are comparable to the CFTC's requirements. To make clear that the CFTC Margin Determination must be a positive determination of comparability, the provision in § 23.23(a)(13)(ii) has been modified to read "and margin

[212] *Id.* at 955.

[213] *Id.* at 957.

[214] Final § 23.23(a)(13)(ii).

requirements for uncleared swaps in a jurisdiction that the Commission has found comparable pursuant to a published comparability determination with respect to uncleared swap margin 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.[215] 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.[216] The Commission is excluding these entities from the definition of SRS, in large part, because the swaps entered into by such entities are already subject to significant regulation, either by the Federal Reserve Board or by the entity's home country.

The Working Group suggested that where a jurisdiction has capital and margin requirements consistent with Basel III requirements, but certain entities located in that jurisdiction are exempted from those requirements, such entities should nonetheless be considered as subject to sufficient capital and margin requirements for the purpose of the

[215] *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); 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 ("DMO") 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.

[216] The most current report was issued in July 2020. Basel Committee on Banking Supervision, Eighteenth progress report on adoption of the Basel regulatory framework (July 2020), available at https://www.bis.org/bcbs/publ/d506.pdf. Current and historical reports are available at https://www.bis.org/bcbs/implementation/rcap_reports.htm?m=3%7C14%7C656%7C59.

proposed SRS exclusion. The Commission is declining to adopt this suggestion here, but it may warrant further consideration in the future. It is not clear whether a foreign jurisdiction's exemption from capital and margin requirements would be based on a risk assessment of the exempted entities, whether such exemptions are granted on a case-by-case basis or provided to entire classes or categories, or whether such exemptions are based on deference to some other form of prudential regulation. Under the Final Rule, where an entity is exempt from a country's capital and margin requirements, such an entity will not be considered to be subject to sufficient capital and margin requirements for the purpose of the SRS exclusion. 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 § 23.23(a)(13)(i) through (ii), the Final Rule classifies 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 § 23.23(a)(14).

With respect to the Working Group comment that the SRS definition should not apply to non-financial entities, the Commission has determined to apply the SRS definition to those non-financial entities that satisfy the risk-based tests contained in the definition. Those entities are not subject to prudential regulation and are, by definition, significant subsidiaries of large U.S. parent entities that may pose a risk to the U.S. financial system, and therefore the Commission believes that such entities should not be excluded from the SRS definition. Accordingly, the Commission is not adding an exception for non-financial entities to the SRS definition. However, Other Non-U.S. Person counterparties to SRSs are not required to include such swaps in either their SD or MSP registration threshold calculations, as discussed below. The Commission has also determined for the Final Rule that non-U.S. swap entities that are neither SRSs nor Guaranteed Entities are not required to comply with the group B and group C requirements (as defined in section VI.A.2 and VI.A.3 below) when entering into foreign-based swaps with certain foreign counterparties, including SRSs that are neither swap entities nor Guaranteed Entities ("SRS End Users").[217] This application of the Final Rule should assuage the commenter's concerns about the effect SRS status will have on the swap trading relationships of a non-financial entity that is an SRS but does not engage in swap dealing or meet the definition of MSP.

In response to Better Markets' comment that the SRS definition does not address evasion and avoidance concerns that are addressed by the conduit affiliate concept, the Commission believes that the SRS definition adequately addresses those concerns within a risk-based framework. The Commission believes that to the extent an off-shore entity is entering into transactions with non-U.S. entities and subsequently back-to-backing those transactions to a U.S. entity, it is appropriate to subject such an entity to certain of the Commission's swap requirements if that entity meets the definition of an SRS and is consequently a significant subsidiary of a U.S. parent entity that is significant to the U.S. financial system. This approach is a risk-based assessment rather than merely a structural or activity-based assessment. Without this risk-based approach, the SD de minimis threshold, which is a strictly activity-based test (*i.e.*, a test based on the aggregate gross notional amount of dealing activity), becomes the de facto risk test of when an entity would be subject to the Commission's swap requirements as an SD. The Commission

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[217] *See infra* section VI.B.

continues to believe that the risk-based SRS test is better-suited to make such a determination.

(v) Counterparty Status and Representations

The Commission acknowledges comments that the implementation of the SRS definition may require entities to reevaluate the status of their counterparties. The Commission understands that SDs may have to re-document whether their counterparties are SRS entities and that this could require, for example, a new industry protocol, which may be an additional burden resulting from the adoption of this rule. The potential burden of this re-assessment of counterparties is considered in the cost-benefit considerations section of this adopting release.

Regarding the ISDA comment that the Commission should permit swap entities to rely on representations obtained under the Guidance with respect to the status of counterparties as conduit affiliates, the Commission responds that the representations made by counterparties with respect to the conduit affiliate concept in the Guidance are not applicable to the SRS definition. Because the definition of an SRS is new and substantially differs from the conduit affiliate concept, such conduit affiliate representations do not capture all counterparties that may be SRSs and may capture entities that fall within the conduit affiliate concept but are excluded from the definition of SRS.

E. Foreign Branch and Swap Conducted Through a Foreign Branch

1. Proposed Rule

The Commission proposed that 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.[218]

The Commission also proposed that 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.[219] In the Proposed Rule, the Commission stated that 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, the Commission proposed that 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 stated that this

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[218] Proposed § 23.23(a)(2). *See* Proposed Rule, 85 FR at 966-968.

[219] Proposed § 23.23(a)(16). *See* Proposed Rule, 85 FR at 966-968.

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 as 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).[220]

2. Summary of Comments

While IIB/SIFMA and JFMC/IBAJ supported the proposed definition of "foreign branch," noting that it was consistent with the definition given to the term in the Guidance, Better Markets recommended that the definition include a requirement that the foreign branch be operated pursuant to U.S. banking laws and regulations and in compliance with applicable restrictions. Better Markets stated that the addition of this prong adds no additional burden and ensures a foreign branch cannot be established outside of the considered restrictions and substantive requirements of U.S. law.

With respect to the proposed definition of a "swap conducted through a foreign branch," Better Markets recommended that the Commission require that the swap be arranged, negotiated, and executed on behalf of the foreign branch solely by persons located outside the United States, rather than permit personnel of the U.S. bank located in the U.S. to participate in the negotiation or execution of a swap so long as 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). Better Markets believes that this formulation defers too significantly to the foreign branches themselves to decide whether the "primarily" restriction has been met, and, instead recommends that the Commission adopt a foreign branch booking restriction that harmonizes with the SEC's approach.

[220] *See* Proposed Rule, 85 FR at 968.

Better Markets argues that such restriction is necessary because foreign branches remain part of the U.S. person in the most critical, risk-related respects.

IIB/SIFMA and JFMC/IBAJ, on the other hand, supported the proposed definition, noting that a requirement that the personnel agreeing to a swap be located in the foreign branch is not necessary because the location of a U.S. bank's employees in connection with a particular swap does not determine whether that swap presents risks to the United States. IIB/SIFMA further argued that because foreign branches of a U.S. bank are generally subject to foreign rules when transacting with non-U.S. counterparties regardless of whether the bank's U.S. personnel are involved, applying additional U.S. rules to swaps with non-U.S. counterparties based on the involvement of U.S. personnel causes market distortions by discouraging non-U.S. counterparties from interacting with U.S. personnel. IIB/SIFMA stated further that since 2013 many U.S. banks have had to rearrange their front office coverage of non-U.S. counterparties in order to address this concern and adoption of the proposed definition would help to reverse this damaging trend.

3. Final Rule and Commission Response

Having considered the foregoing comments, the Commission has determined to adopt the definitions of "foreign branch" and "swap conducted through a foreign branch" as proposed.[221] Regarding Better Markets' recommendation that a fifth prong be added to the definition of "foreign branch" to more closely align the definition with the definitions used by the prudential regulators, as noted below, the definition of "foreign branch" proposed by the Commission is consistent with the definitions of "foreign

[221] Final § 23.23(a)(2) and (16).

branch" in the regulations of the Federal Reserve Board, the Office of the Comptroller of the Currency ("OCC"), and the Federal Deposit Insurance Corporation ("FDIC").[222]

Regarding Better Markets' comment that a foreign branch should be treated as a U.S. person unless the employees negotiating and agreeing to the terms of the swap are exclusively located in a foreign branch, the Commission responds that such a prescriptive limitation is not required to prevent evasion of the Commission's swap requirements through booking strategies. By requiring swaps to be entered into by a foreign branch in its normal course of business, primarily by personnel located in the foreign branch, the definition proposed by the Commission provides a workable standard of review that will permit the Commission to detect evasive booking strategies while not discouraging non-U.S. counterparties from interacting with U.S. personnel.

The Commission is adopting the factors listed in the proposed definition of "foreign branch" for determining when an entity is considered a foreign branch for purposes of the Final Rule.[223] 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,[224] operate for valid business reasons, and be engaged in the business of banking or finance and be subject to substantive

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[222] *See infra* notes 226- 228, and accompanying text.

[223] As discussed in sections III.B.2 and IV.B.2, *infra*, the Final Rule does not require an Other Non-U.S. Person to count toward its SD and MSP threshold calculations swaps conducted through a foreign branch of a registered U.S. SD.

[224] 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 their general ledgers 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*.

banking or financing regulation in its non-U.S. jurisdiction will prevent an entity from setting up shell operations outside the United States in a jurisdiction without substantive banking or financial regulation in order to evade Dodd-Frank Act requirements and CFTC regulations.[225] This definition incorporates concepts from the Federal Reserve Board's Regulation K,[226] the FDIC's international banking regulation,[227] and the OCC's "foreign branch" definition.[228]

The definition of "foreign branch" in the Final Rule is also consistent with the SEC's approach, which, for purposes of security-based swap dealer regulation, defines a 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.[229] The Commission's intention is to ensure that the definition provides sufficient clarity as to

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[225] 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.

[226] Regulation K is a regulation issued by the 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 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).

[227] 12 CFR part 347 is a regulation issued by the FDIC 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. 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.

[228] 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).

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

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.

A foreign branch does not include an affiliate of a U.S. bank that is incorporated or organized as a separate legal entity.[230] For similar reasons, the Commission declines in the Final Rule to recognize foreign branches of U.S. persons separately from their U.S. principal for purposes of registration.[231] 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 calibrating the requirements for counting certain swaps entered into through a foreign branch, as described in sections III.B.2 and IV.B.2, and calibrating the requirements otherwise applicable to foreign branches of a registered U.S. SD, as discussed in section VI. One of the benefits, as discussed below, will be to enable foreign branches of U.S. banks to have greater access to foreign markets.

The definition of "swap conducted through a foreign branch" 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.

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[230] This is similar to the approach described in the Guidance. *See* Guidance, 78 FR at 45328-45329.

[231] This is similar to the approach described in the Guidance. *See id.* at 45315, 45328-45329.

bank through which payments and deliveries under the swap are made. This approach is consistent with the standard ISDA Master Agreement, which requires that each party specify an "office" for each swap, which is generally where a party "books" a swap and/or the office through which the party makes and receives payments and deliveries.[232]

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. This requirement should 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 as 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). As noted above, the Commission believes this is a workable standard of review that will permit the Commission to detect evasive booking strategies by examining the types of swaps booked in the foreign branch and determining whether any type of swap is primarily entered into by personnel located in the United States.

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

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[232] 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.

F. *Swap Entity, U.S. Swap Entity, and Non-U.S. Swap Entity*

The Commission proposed that the term "swap entity" would mean a person that is registered with the Commission as a SD or MSP pursuant to the CEA.[233] In addition, the Commission proposed to define "U.S. swap entity" as a swap entity that is a U.S. person, and "non-U.S. swap entity" as a swap entity that is not a U.S swap entity.[234]

The Commission did not receive any comments on these proposed definitions, and is adopting them as proposed.[235]

G. *U.S. Branch*

The Commission proposed that 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.[236]

The only comment the Commission received on this definition was from JFMC/IBAJ, stating that they generally supported the proposed new definition, as they believe it provides a clear and objective standard and provides market participants with legal certainty. Thus, the Commission is adopting the definition of "U.S. branch" as proposed.[237]

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[233] *See* Proposed § 23.23(a)(15); Proposed Rule, 85 FR at 968, 1003.

[234] *See* Proposed § 23.23(a)(10) and (23); Proposed Rule, 85 FR at 968, 1003.

[235] Final § 23.23(a)(11), (18), and (24).

[236] *See* Proposed § 23.23(a)(20); Proposed Rule, 85 FR at 968, 1003.

[237] Final § 23.23(a)(21).

H. Swap Conducted Through a U.S. Branch

1. Proposed Rule

The Commission proposed that 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 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.[238]

2. Summary of Comments

The same as for the definition of "U.S. branch" above, JFMC/IBAJ generally supported the proposed definition of "swap conducted through a U.S. branch," as they believe it provides a clear and objective standard and provides market participants with legal certainty. However, JFMC/IBAJ, CS, and IIB/SIFMA asked the Commission to conform the definition to the definition of "swap conducted through a foreign branch" by (1) including a "normal course of business" prong, and (2) applying the definition conjunctively rather than disjunctively. JFMC/IBAJ stated that they see no policy rationale or countervailing policy benefit of these inconsistencies. CS agreed, stating that, as a matter of policy, it encourages the CFTC to provide consistent flexibility for U.S. branches and foreign branches. IIB/SIFMA stated that, in accordance with principles of international comity, the Commission should instead take a balanced and symmetric approach to recognizing when home versus host country regulators have an interest in applying their rules and that the Proposed Rule offers no justification for this

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[238] *See* Proposed § 23.23(a)(17); Proposed Rule, 85 FR at 968, 1003.

asymmetric approach. ISDA also requested that the Commission apply the definition conjunctively, stating that only when a swap is booked at a particular entity can it be considered a swap transaction that is attributed to such an entity.

3. Final Rule – Swap Booked in a U.S. Branch

After carefully considering the comments, the Commission is adopting the definition with certain modifications reflected in the rule text in this release.[239] The Commission is removing the first prong of the definition such that the only relevant factor is whether the swap is reflected in the local accounts of the U.S. branch, meaning swaps for which the U.S. branch holds the risks and rewards, with the swap being accounted for as an obligation of the branch on the balance sheet of the U.S. branch under applicable accounting standards[240] and under regulatory reporting requirements[241] (*i.e.*, the swap is "booked" in the U.S. branch). This standard captures activity of non-U.S. banking organizations taking place in their U.S. branches that should be treated as taking place in the United States to prevent evasion of CFTC rules by such organizations. As discussed in the Proposed Rule, in the case of the swap activities of the U.S. branches of non-U.S. banking organizations, the Commission has determined that the location of personnel involved in arranging, negotiating, and execution activities will not be relevant for application of the Final Rule.[242] For this reason, the Commission had intended in the

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[239] Final § 23.23(a)(16).

[240] Or would be accounted for on its balance sheet under applicable accounting standards if the U.S. branch were a separate legal entity.

[241] For example, the swap is included in the non-U.S. person's Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks published by the Federal Financial Institution Examinations Council (FFIEC 002).

[242] *See infra* section V; Proposed Rule, 85 FR at 978.

Proposed Rule only to reach swaps that are booked in the United States under the definition of "swap conducted through a U.S. branch."

The Commission now understands that a U.S. branch may be listed as the office through which a non-U.S. person makes and receives deliveries under a swap or as the office identified in the master, netting, or similar trading agreement without the swap being booked in a U.S. branch. Commenters explained, for example, that the U.S. branch is often listed for payments and deliveries for swaps denominated in U.S. Dollars even where the risk/benefit of the swap resides outside the United States.

Further, to emphasize that booking is the focus of the definition, the Commission is changing the term from "swap conducted through a U.S. branch" to "swap booked in a U.S. branch" (and, accordingly, revising the definitions of "foreign-based swap" and "foreign counterparty" below to reflect this change in terminology).

In response to comments objecting to the differences in the proposed definitions of "swap conducted through a foreign branch" and "swap conducted through a U.S. branch," the Commission is retaining these differences because, as a general matter, U.S. swap entities should be subject to all of the Commission's Title VII requirements set forth in the Final Rule. Because classifying a swap as a "swap conducted through a foreign branch" makes a U.S. swap entity eligible for certain exceptions from these requirements and substituted compliance for the swap under the Final Rule, merely booking a swap in the foreign branch is not sufficient for a U.S. swap entity to qualify for these exceptions and substituted compliance. Rather, the U.S. swap entity is required also to show that the swap is a transaction of a type that is endemic to the foreign market (*i.e.*, that it is a type of transaction entered into by personnel in the foreign branch in the normal course of the business of the branch, rather than a transaction more normally entered into in a different location and merely booked in the foreign branch to evade CFTC regulatory requirements). Hence, as discussed above, the Commission is including a "normal course of business" prong in the definition of "a swap conducted through a foreign branch" and requiring that all three prongs of the definition be satisfied.

As noted in the Proposed Rule and consistent with the Commission's approach to foreign branches, a U.S. branch of a non-U.S. banking organization does not include a U.S. affiliate of the organization that is incorporated or organized as a separate legal entity. Also consistent with this approach, the Commission declines in the Final Rule to recognize U.S. branches of non-U.S. banking organization separately from their non-U.S. principal for purposes of registration.

I. Foreign-Based Swap and Foreign Counterparty

1. Proposed Rule

The Commission proposed that 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.[243] Further, 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.[244] Under the Proposed Rule, together with the proposed defined terms "foreign branch," "swap conducted through a foreign branch," "U.S. branch," and "swap

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[243] *See* Proposed § 23.23(a)(4); Proposed Rule, 85 FR at 968-969, 1002.

[244] *Id.*

conducted through a U.S. branch," these terms were to be used to determine which swaps would 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 would be treated as domestic swaps not eligible for such relief.

2. Summary of Comments

AIMA was supportive of the definition of "foreign counterparty" and, in particular, its application to CIVs. However, JFMC/IBAJ requested that the Commission expand the definition of "foreign-based swap" and "foreign counterparty" under the proposed exceptions from the group B and C requirements (described in sections VI.A.2 and VI.A.3 below) to cover swaps conducted through the U.S. branch of a non-U.S. swap entity. JFMC/IBAJ stated that these are swap trades between two non-U.S. persons and thus should be governed by the home country regulation of the non-U.S. persons according to principles of international comity, and that there is no material importation of risk to the U.S. financial system and hence a lack of sufficient jurisdictional nexus for purposes of CEA section 2(i). JBA similarly requested that, generally, swap requirements not apply to U.S. branches in a different manner than the related non-U.S person.

3. Final Rule

After carefully considering the comments, the Commission is adopting the definitions of "foreign-based swap" and "foreign counterparty" as proposed, with a minor technical modification included in the rule text in this release.[245] Specifically, to reflect

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[245] Final § 23.23(a)(4) and (5).

that the term "swap conducted through a U.S. branch" is being replaced with the term "swap booked in a U.S. branch," each of the definitions of "foreign-based swap" and "foreign counterparty" is being revised to replace the term "swap conducted through a U.S. branch" with the term "swap booked in a U.S. branch."

When a swap is booked in a U.S. branch of a non-U.S. swap entity, that swap is part of the U.S. swap market, and, accordingly, the group B and group C requirements (described in sections VI.A.2 and VI.A.3 below) should generally apply.[246] Therefore, the Commission has determined to carve out a swap booked in a U.S. branch from the definitions of "foreign-based swap" and "foreign counterparty."

As discussed in the Proposed Rule, the Commission is using the terms "foreign-based swap" and "foreign counterparty" to identify the types of swaps that are eligible for certain relief, consistent with section 2(i) of the CEA, in order that swaps that demonstrate sufficient indicia of being domestic generally remain subject to the Commission's requirements under the Final Rule, notwithstanding that the swap is entered into by a non-U.S. swap entity or a foreign branch of a U.S. swap entity. Otherwise, an entity or branch might simply be established outside of the United States 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.[247] However, consistent with

[246] The Commission notes that swap activities of the U.S. branches of non-U.S. banking organizations take place inside the United States and, thus, section 2(i)'s applicability (*i.e.*, to activities "outside the U.S.") is not implicated. Nevertheless, as discussed in sections VI.B and VI.C, *infra*, the Commission has determined under the Final Rule to provide certain exceptions from application of the group C requirements and the availability of substituted compliance for the group B requirements for certain swaps booked in the U.S. branches of non-U.S. swap entities.

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

section 2(i) of the CEA, 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 exceptions from the group B and group C requirements and portions of the Commission's substituted compliance regime (discussed below in sections VI.B and VI.C), are designed to apply only 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 booked in a U.S. branch – and a swap conducted through a foreign branch such that it satisfies the definition of a "foreign-based swap" above. They are generally not applicable to swaps of non-U.S. swap entities that are booked in 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 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 these circumstances, demonstrates sufficient indicia of being a domestic swap to be treated as such for purposes of the Final Rule. Similarly, in certain cases, the availability of an exception or substituted compliance for a swap depends on whether the counterparty to such a swap qualifies as a "foreign counterparty" under the Final Rule. The Commission is establishing 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, remain subject to the Commission requirements under the Final Rule.

The Commission's approach in the Final Rule to limit certain relief for U.S. branches of non-U.S. swap entities is parallel to the Commission's approach in the Final Rule to provide certain exceptions from Commission requirements or substituted compliance for certain 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.

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").[248] 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.[249]

In accordance with CEA section 1a(49), the Commission issued the Entities Rule,[250] 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.[251] 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

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[248] 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.

[249] 7 U.S.C. 1a(49)(D).

[250] Entities Rule, 77 FR 30596.

[251] 17 CFR 1.3, Swap dealer, paragraph (4); Entities Rule, 77 FR 30596.

dealing activity involving counterparties unless, during the preceding 12 months, the aggregate gross notional amount of the swaps connected with those dealing activities exceeds the de minimis threshold.[252] 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 amount of the swaps connected with the dealing activities of its affiliates under common control.[253] For purposes of the Commission's interpretation of the aggregation requirement in the cross-border context as set forth in this release, the Commission construes "affiliates under common 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.[254] Accordingly, any reference in the Commission's aggregation interpretation to "affiliates under common control" with a person includes affiliates that are controlling, controlled by, or under common control with such person.

The Commission is now adopting 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 Final 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 includes a particular swap in its de minimis threshold calculation depends on how the entity and its

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[252] 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 id.*, paragraphs (4)(i)(A)-(B). *See generally* De Minimis Exception to the Swap Dealer Definition, 83 FR 56666 (Nov. 13, 2018).

[253] 17 CFR 1.3, Swap dealer, paragraph (4)(i)(A).

[254] *See* Entities Rule, 77 FR at 30631 n.437.

counterparty are 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

The Commission is adopting, as proposed and consistent with the Guidance, the requirement that a U.S. person include all of its swap dealing transactions in its de minimis threshold calculation without exception.[255] The Commission did not receive comments regarding this requirement. As discussed in section II.B above, the term "U.S. person" encompasses 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 Dodd-Frank Act, regardless of the U.S. person status of its counterparty. In addition, a person's status as a U.S. person is determined at the entity level and, thus, a U.S. person includes 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 includes in its SD de minimis threshold calculation dealing swaps entered into by a foreign branch of the U.S. person.[256]

B. Non-U.S. Persons

Under the Final Rule, as discussed in more detail below, whether a non-U.S. person needs to include a swap in its de minimis threshold calculation depends 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 Final Rule requires a person that is a Guaranteed Entity or an SRS to count all of its dealing swaps

[255] Final § 23.23(b)(1). *See* Proposed Rule, 85 FR at 970-971, 1004; Guidance, 78 FR at 45326.

[256] Proposed Rule, 85 FR at 970-971. 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.

towards the de minimis threshold.[257] In addition, an Other Non-U.S. Person is 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 U.S. SD.[258] Further, subject to certain exceptions, the Final Rule requires 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

The Commission proposed to require an SRS to include all of its dealing swaps in its de minimis threshold calculation without exception.[259]

IIB/SIFMA stated that, generally, the Commission should not require a non-U.S. person, whether or not it is an SRS or other FCS, to include dealing swaps with a non-U.S. person in its SD de minimis threshold calculation when the risk of such swaps is transferred to an affiliated, registered U.S. SD. In such a situation, IIB/SIFMA asserted that there is no significant potential for risk to the United States or evasion of the Dodd-Frank Act because the Commission already can exercise appropriate regulatory oversight through direct regulation of the registered SD, which is subject to Dodd-Frank Act

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[257] As discussed in section II.C, *supra*, for purposes of this release and ease of reading, a non-U.S. person whose obligations under a swap 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 certain swaps and not others (including, *e.g.*, where the non-U.S. person is guaranteed only with respect to its swaps with certain counterparties). Thus, a non-U.S. person could be a Guaranteed Entity or an Other Non-U.S. Person, depending on the specific swap.

[258] As stated, "swap conducted through a foreign branch" means 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.

[259] Proposed § 23.23(b)(1); Proposed Rule, 85 FR at 971, 1004.

provisions such as risk management requirements and Commission or prudential regulator margin and capital requirements. IIB/SIFMA argued that this consideration underlies the Commission's decision to exclude affiliates of a registered SD from the "conduit affiliate" definition in the Guidance, as well as the similar approach taken by the SEC in its implementation of the Dodd-Frank Act.

After considering this comment, the Commission is adopting this requirement as proposed.[260] As discussed in section II.D above, the SRS test identifies 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 IHC, or subject to comparable capital and margin rules, raises the concerns intended to be addressed by the Dodd-Frank Act requirements addressed by the Final Rule, regardless of the status of its counterparty as a U.S. person or non-U.S. person. 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 SRSs to avoid application of the Dodd-Frank Act SD requirements. Allowing swaps entered into by SRSs, which have the potential to affect 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 Final Rule. Applying the same standard to similar transactions helps to limit those incentives and regulatory implications. Because the SRS definition is a risk-based test, the Commission has determined not to include a carve-out for back-to-back swaps to SDs, as was

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[260] Final § 23.23(b)(1).

provided in the Guidance for conduit affiliates. Additionally, the SRS definition, as adopted in the Final Rule, already includes a carve-out for affiliates of BHCs and IHCs. This approach allows for streamlined application of the rule, and the comment letters have not identified specific downsides to this approach.[261]

In addition, a person's status as an SRS is determined at the entity level and, thus, an SRS is required to include in its SD de minimis threshold calculation the dealing swaps of its operations that are part of the same legal person, including those of its branches.[262]

The Proposed Rule also provided that 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).[263] JFMC/IBAJ supported this approach, while JBA asserted that an Other Non-U.S. Person should not have to count a swap entered into with a non-U.S. person in any circumstance. As noted above, an SRS is required to count all of its dealing swaps. However, the Commission continues to believe that 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 its de minimis threshold could cause the Other Non-U.S. Person to stop engaging in swap activities with SRSs. Though an SRS is required to count all of its dealing swaps, for the reasons stated above, the Commission believes that it is important to ensure that SRSs, particularly ones that are a commercial or non-financial entity that do

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[261] *See* Proposed Rule, 85 FR at 971.

[262] *Id.*

[263] *Id.*

not engage in swap dealing activities, continue to have access to swap liquidity from Other Non-U.S. Persons for hedging or other non-dealing purposes.

2. Swaps with a U.S. Person

Consistent with the Guidance, the Commission proposed to 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 if such swaps meet the definition of being "conducted through a foreign branch" of such registered SD.[264]

IIB/SIFMA, JFMC/IBAJ, and JBA supported allowing an Other Non-U.S. Person to exclude swap dealing transactions conducted through a foreign branch of a registered SD counterparty. IIB/SIFMA agreed that the Commission's regulatory interest in these swaps is not sufficient to warrant a competitive disadvantage for foreign branches of U.S. SDs, especially considering that other Dodd-Frank Act requirements, such as margin, mitigate the risk of these swaps to the U.S. SD. Additionally, IIB/SIFMA stated that the exclusion helps prevent market fragmentation by enabling Other Non-U.S. Persons to access liquidity provided by U.S. SDs through their foreign branches. On the other hand, AFR asserted that the Proposed Rule would allow branches of U.S. persons, which are actually formally and legally part of the parent U.S. organization, to effectively act as non-U.S. persons.

After considering the comments, the Commission is adopting this aspect of the cross-border application of the SD registration threshold as proposed.[265] As discussed in

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[264] Proposed § 23.23(b)(2)(i); Proposed Rule, 85 FR at 971-972, 1004. *See* Guidance, 78 FR at 45323-45324.

[265] Final § 23.23(b)(2)(i).

section II.B, 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. 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 and significant adverse effect on its U.S. counterparties, which could in turn create the risk of disruptions to the U.S. financial system.[266]

Allowing a non-U.S. person to exclude swaps conducted through a foreign branch of a registered SD counterparty from its de minimis threshold calculation is consistent with the Guidance.[267] In response to AFR's comment that the Proposed Rule allows foreign branches of U.S. persons to effectively act as non-U.S. persons, the Commission continues to believe 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, a swap conducted through a foreign branch of a registered SD triggers certain Dodd-Frank Act transactional requirements (or comparable requirements), particularly margin requirements, and thus, such swap activity is not conducted fully outside the Dodd-Frank Act regime. Moreover, in addition to certain Dodd-Frank Act requirements that apply to such swaps, other foreign regulatory requirements may also apply similar transactional

[266] Proposed Rule, 85 FR at 971-972.

[267] *Id.* *See* Guidance, 78 FR at 45323-45324.

requirements to the transactions.[268] Accordingly, the Commission believes that it is 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 counterparty. However, this exception does not apply to Guaranteed Entities (discussed below) or SRSs (discussed above), who have to count all of their dealing swaps.

The Commission also requested comment on whether it would 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, and whether it would 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 of its counterparty.[269] IIB/SIFMA supported not requiring a U.S. branch of a non-U.S. banking organization to include all of its swap dealing transactions in its SD de minimis threshold calculation as if they were swaps entered into by a U.S. person or to require an Other Non-U.S. Person to include in its SD de minimis threshold calculation dealing swaps conducted through such a branch of its counterparty. IIB/SIFMA stated that swaps between a U.S. branch and an Other Non-U.S. Person do not present risks to the United States that would justify applying the Commission's SD requirements. JBA also stated that Other Non-U.S. Persons should not have to count swaps conducted through a U.S.

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

[269] Proposed Rule, 85 FR at 973. *See* discussion of the modification of the definition of a "swap conducted through a U.S. branch" to be a "swap booked in a U.S. branch" in section II.H.3, *supra*.

branch of a counterparty since such an approach may lead to Other Non-U.S. Persons decreasing activity with U.S. branches.

Having considered the foregoing comments, in this Final Rule, the Commission is not requiring a U.S. branch of an Other Non-U.S. Person to count all of its swap dealing transactions in its SD threshold calculation, as if they were swaps entered into by a U.S. person. Rather, a U.S. branch is required to count swaps pursuant to the requirements for Other Non-U.S. Persons (*e.g.*, count swaps with U.S. persons, Guaranteed Entities subject to certain exceptions, etc.). Additionally, an Other Non-U.S. Person is not required to include in its SD de minimis threshold calculation dealing swaps booked in a U.S. branch of a counterparty, unless that swap has to be counted pursuant to other requirements of this Final Rule.

3. Guaranteed Swaps

(i) Swaps Entered into By a Guaranteed Entity

In an approach that is generally consistent with the Guidance, the Commission proposed to require a non-U.S. person to include in its de minimis threshold calculation swap dealing transactions where its obligations under the swaps are guaranteed by a U.S. person.[270] No comments were received regarding this aspect of the Proposed Rule.

The Commission is adopting this requirement as proposed,[271] because the swap obligations of a Guaranteed Entity are identical, in relevant aspects, to a swap entered

[270] Proposed § 23.23(b)(2)(ii); Proposed Rule, 85 FR at 972, 1004. 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 45312-45313. As discussed above, the Final Rule does not require that the guarantor be an affiliate of the guaranteed person for that person to be a Guaranteed Entity.

[271] Final § 23.23(b)(2)(ii).

into directly by a U.S. person. As a result of the guarantee, the U.S. guarantor generally 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 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.[272]

Further, 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 Final Rule. Applying the same standard to similar transactions helps to limit those incentives and regulatory implications.[273]

(ii) Swaps Entered into With a Guaranteed Entity

The Commission also proposed to require a non-U.S. person to 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

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[272] Proposed Rule, 85 FR at 972. This view is consistent with the SEC's approach in its cross-border rule. *See* SEC Cross-Border Rule, 79 FR at 47289.

[273] Proposed Rule, 85 FR at 972.

subject to a guarantee by a U.S. person that is a non-financial entity.[274] The Commission also invited comment on whether it should the follow the SEC's approach, which does not require a non-U.S. person that is not guaranteed by a U.S. person to count dealing swaps with a Guaranteed Entity.[275]

IIB/SIFMA, ISDA, JFMC/IBAJ, and JBA recommended that the Commission further conform this provision with the Guidance by expanding the exceptions to also cover a Guaranteed Entity that engages in de minimis swap dealing activity and is affiliated with a registered SD. IIB/SIFMA and ISDA noted that the Commission's regulatory concerns are addressed because the Guaranteed Entity would already be required to count the swap towards its de minimis threshold. IIB/SIFMA, ISDA, and JFMC/IBAJ noted that absent this exception, Other Non-U.S. Persons may choose not to trade with Guaranteed Entities, leading to increased market fragmentation or competitive disadvantages. JFMC/IBAJ also stated that there has been no material change in the swaps market since issuance of the Guidance warranting removing this exception. JBA commented that Other Non-U.S. Persons should not have to count swaps where the non-U.S. counterparty transfers risks to an affiliated U.S. SD because of the burdens associated with such an approach, and the limited risks arising from transactions between two non-U.S. persons. JBA also recommended that the CFTC follow the SEC approach and not require a non-U.S. person to count a swap with a Guaranteed Entity because it is burdensome to assess whether a guarantee exists.

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[274] Proposed § 23.23(b)(2)(iii); Proposed Rule, 85 FR at 973, 1004.

[275] Proposed Rule, 85 FR at 974. The SEC noted that "concerns regarding the risk posed to the United States by such security-based 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." SEC Cross-Border Rule, 79 FR at 47322.

Consistent with the Guidance, the Commission is adopting, as proposed, the requirement 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.[276] Additionally, after carefully considering the comments, and to maintain consistency with the Guidance, the Commission is also adopting an exception that allows a non-U.S. person to exclude from its de minimis calculation swaps entered into with a Guaranteed Entity that is itself below the de minimis threshold and is affiliated with a registered SD.[277]

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 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, swaps of a non-U.S. person with a Guaranteed Entity should receive the same treatment as swaps with a U.S. person. The exceptions are intended to address those situations where the risk of the swap between the non-U.S. person and the Guaranteed Entity is otherwise managed under the Dodd-Frank Act swap regime or is primarily outside the U.S.

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[276] Final § 23.23(b)(2)(iii)(A) and (B). *See* Guidance, 78 FR at 45324.

[277] Final § 23.23(b)(2)(iii)(C). *See* Guidance, 78 FR at 45324.

financial industry.[278] JBA supported the SEC's approach, which, as noted, does 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 any guaranteed entity toward its de minimis threshold in any case.[279] Given the broader global scope of the swaps market regulated under the Commission's swap regime versus the relatively more limited U.S.-focused scope of the security-based swap market regulated under the SEC's security-based swap regime, the Commission has determined to treat swaps with Guaranteed Entities differently.

Where an Other Non-U.S. Person enters into swap dealing transactions with a Guaranteed Entity that is a registered SD, the Commission will 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.[280]

In addition, an Other Non-U.S. Person need 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

[278] Proposed Rule, 85 FR at 972.

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

[280] Proposed Rule, 85 FR at 972.

such activities primarily occur outside the U.S. financial sector.[281] For purposes of the Final 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).[282]

Lastly, as discussed, the Commission requested comment on whether it should expand the exception to not require a non-U.S. person that is not a Guaranteed Entity to count dealing swaps with a Guaranteed Entity, consistent with the SEC. IIB/SIFMA, ISDA, JFMC/IBAJ, and JBA requested a narrower version of this exception, noting that the Guidance allowed a non-U.S. person to exclude from its de minimis calculation swaps entered into with a Guaranteed Entity that is itself below the de minimis threshold and is affiliated with a registered SD. The Guidance reflected the Commission's view that when the aggregate level of swap dealing by a non-U.S. person that is not a guaranteed affiliate, considering both swaps with U.S. persons and swaps with unregistered guaranteed affiliates, exceeds the de minimis level of swap dealing, the non-U.S. person's swap dealing transactions have the requisite direct and significant connection with activities in, or effect on, commerce of the United States.[283] The Commission believes, however, that where the counterparty to a swap is a Guaranteed Entity and is not a registered SD, the Commission's regulatory concerns, such as systemic risk to U.S. financial markets, are addressed because the Guaranteed Entity engages in a level of swap dealing below the de minimis threshold and is part of an

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[281] Moreover, the SRS definition includes those non-financial U.S. parent entities that meet the risk-based thresholds set out in section II.D, *supra*.

[282] Proposed Rule, 85 FR at 972.

[283] Guidance, 78 FR at 45324.

affiliated group with an SD.[284] Risk to the Guaranteed Entity should be mitigated by the SD's risk management program, which under Commission rules must take account of risks posed by affiliates and must be integrated into risk management at the consolidated entity level.[285] Including this exception also addresses concern that its elimination would discourage Other Non-U.S. Persons from entering into swaps with Guaranteed Entities, creating competitive disadvantages.

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 amount of any swap dealing transactions entered into by its affiliates under common control.[286] 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, consistent with the Guidance, the Commission proposed to require a potential SD, whether a U.S. or non-U.S. person, to aggregate all swaps connected with its dealing activity with those of persons controlling, controlled by, or under common control with 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.[287]

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[284] *Id.*

[285] 17 CFR 23.600(c)(1)(ii).

[286] 17 CFR 1.3, Swap dealer, paragraph (4).

[287] Proposed Rule, 85 FR at 972-973; Guidance, 78 FR at 45323.

Better Markets supported the proposed aggregation requirement because it would prevent structuring to avoid or evade the de minimis threshold. As discussed above in connection with the definition of "significant risk subsidiary," AFR stated that it would be simple for large international banks and other significant actors to conduct dealing through foreign subsidiaries that need not be counted toward de minimis thresholds at the subsidiary level. AFR claimed that the aggregation provision is negated by the fact that affiliates which are not SRSs would not have to count non-guaranteed swaps with other non-U.S., non-SRS persons toward their own de minimis calculations. In this way, it argued that the weakness of the other definitions in the Proposed Rule affects the calculation of the de minimis registration thresholds.

Having considered these comments, the Commission is adopting this interpretation of the cross-border application of the SD registration threshold as proposed, and consistent with the Guidance.[288] 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) 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 addresses 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

[288] Proposed Rule, 85 FR at 972-973; Guidance, 78 FR at 45323.

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. The Commission's approach ensures that the aggregate gross notional amount of applicable swap dealing transactions of all such unregistered U.S. and non-U.S. affiliates does not exceed the de minimis level.[289]

In response to AFR's comment, pursuant to the status quo under the aggregation policy set forth in the Guidance, foreign subsidiaries of U.S. persons (that are not "conduit affiliates" as described in the Guidance) have not counted non-guaranteed swaps with other non-U.S. persons toward their de minimis calculations and U.S. person parent entities have therefore not aggregated such swaps with their own or their affiliates' de minimis calculations. Thus, the new SRS category expands the swaps included by the aggregation requirement rather than "negating the aggregation provision" as claimed by AFR.

D. Certain Exchange-Traded and Cleared Swaps

The Commission proposed, in an approach that is generally consistent with the Guidance, to allow an Other Non-U.S. Person to exclude from its 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

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[289] Proposed Rule, 85 FR at 972-973.

pursuant to part 48 of its regulations,[290] if such swap is also cleared through a registered or exempt derivatives clearing organization ("DCO").[291]

IIB/SIFMA recommended that this exception be expanded to cover swaps executed anonymously by an Other Non-U.S. Person on a non-U.S. trading venue and cleared by a non-U.S. clearing organization, regardless of whether the trading venue and clearing organization are registered or exempt from registration with the Commission. IIB/SIFMA stated that: (1) with such trades, the Other Non-U.S. Person cannot determine whether the swaps would count towards the SD de minimis threshold; (2) even if the Other Non-U.S. Person was registered as an SD, the swaps generally would not be subject to the Commission's external business conduct rules; and (3) a non-U.S. clearing organization becomes the counterparty to the Other Non-U.S. Person, and therefore the swaps do not present risk to the U.S. that would justify application of the Commission's risk mitigation rules. IIB/SIFMA stated that if the Other Non-U.S. Person's original counterparty was a U.S. person, the Commission's SEF and DCO registration requirements would independently require the trading venue and clearing organization to register with the Commission or obtain an exemption from registration and, therefore, it is not necessary for the Commission to limit this exception in a manner that would indirectly expand the SEF and DCO registration requirements to non-U.S. trading venues and clearing organizations with Other Non-U.S. Person participants.

[290] The Commission considers the 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.

[291] Proposed § 23.23(d); Proposed Rule, 85 FR at 973, 1004. *See* Guidance, 78 FR at 45325.

Similarly, JFMC/IBAJ generally supported the exception, but also requested that the Commission not require the clearing organization or trading venue to be registered or exempt from registration with the CFTC because, in their view, the same policy rationale of exempting cleared swaps executed anonymously on a SEF or DCM applies to swaps executed on non-U.S. trading venues or clearing organizations operating without a CFTC registration or exemption. JFMC/IBAJ also recommended that the scope be expanded to include cleared swaps executed bilaterally outside a trading venue. JBA generally supported the proposal but also recommended that the exclusion be available for all cleared swaps, regardless of whether they are anonymously entered into on a DCM, registered or exempt SEF, or an FBOT, because risk to the U.S. would be limited after the swap is cleared. JSCC recommended that a non-U.S. person should be able to exclude swaps entered into with a U.S. person from the de minimis threshold calculation, if the swap is cleared with a registered DCO or exempt DCO because any non-U.S. person-related risk arising from the swap will be replaced and instead managed by the DCO.

Better Markets stated that the exception must be amended to limit the exclusion to DCO-cleared, anonymously SEF or DCM-executed swaps in which neither counterparty is subsequently disclosed through the practice of post-trade name give-up. Additionally, Better Markets objected to the expansion of the exchange-trading exclusion for any swaps anonymously executed or cleared through an exempted intermediary.

Having considered these comments, the Commission is adopting this exception as proposed.[292] When a non-U.S. person enters into a swap that is executed anonymously

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[292] Final § 23.23(d).

on a registered or exempt SEF, DCM, or registered FBOT, the Commission recognizes that the non-U.S. person does not have the necessary information about its counterparty to determine whether the swap should be included in its SD de minimis threshold calculation. The Commission therefore has determined that in this case the swap should be excluded altogether due to these practical difficulties.[293] However, the exception is limited to Other Non-U.S. Persons since, as discussed, Guaranteed Entities and SRSs have to count all of their dealing swaps towards the threshold, so the practical obstacles that would challenge Other Non-U.S. Persons are not relevant for Guaranteed Entities and SRSs.

The Final Rule expands the exception as it appeared in the Guidance 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 appropriate governmental authorities in the SEF or DCO's home country.[294] 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,

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[293] *See* Proposed Rule, 85 FR at 973. 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.

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

the foreign SEF or DCO is subject to comprehensive regulation that is comparable to that applicable to registered SEFs and DCOs.

The Commission has determined not to expand at this time the exception to allow an Other Non-U.S. Person to exclude swaps executed anonymously on an exchange and which are subsequently cleared, regardless of whether the exchange and clearing organization are registered or exempt from registration with the Commission. Commenters argued that if the Other Non-U.S. Person's original counterparty was a U.S. person, the Commission's SEF and DCO registration requirements would independently require the trading venue and clearing organization to register with the Commission or obtain an exemption from registration. While guidance from DMO has suggested that this might be the case with respect to SEFs and DCMs,[295] the Commission has not taken a formal position on whether registration of a SEF or DCM is required where a U.S. person participates on the trading facility, and has stated that it will do so in the future.[296] The Commission may consider expanding the exception pending other amendments to the SEF/DCO regulations and registration requirements.

In response to comments that anonymity should not be required, the Commission proposed this exception (and included it in the Guidance) because when a trade is entered

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[295] Division of Market Oversight Guidance on Application of Certain Commission Regulations to Swap Execution Facilities, at 2 n.8 (Nov. 15, 2013) ("[DMO] expects that a multilateral swaps trading platform located outside the United States that provides U.S. persons . . . with the ability to trade or execute swaps on or pursuant to the rules of the platform, either directly or indirectly through an intermediary, will register as a SEF or DCM.").

[296] *See* Swap Execution Facilities and Trade Execution Requirement, 83 FR 61946, 61961 n.106 ("[T]he Commission learned that many foreign multilateral swaps trading facilities prohibited U.S. persons and U.S-located persons from accessing their facilities due to the uncertainty that the guidance created with respect to SEF registration. The Commission understands that these prohibitions reflect concerns that U.S. persons and U.S.-located persons accessing their facilities would trigger the SEF registration requirement. . . . [T]he Commission expects to address the application of CEA section 2(i) to foreign multilateral swaps trading facilities, including foreign swaps broking entities, in the future.").

into anonymously on an exchange, 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.[297] Therefore, these practical difficulties justify the exclusion of the swap altogether. However, if the identity of the counterparty is known to be a U.S. person, then the Other Non-U.S. Person should be seen to be participating in the U.S. swap market. Thus, the Commission has determined that such a non-U.S. person should count such swaps towards its de minimis threshold as otherwise required. Where the U.S. person status of a counterparty is known to the non-U.S. person, the Commission sees no reason to treat a cleared swap differently in the cross-border context than such swap is treated in the domestic U.S. context where cleared swaps entered into in a dealing capacity, whether executed anonymously or otherwise, count toward the SD de minimis threshold.

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.[298] 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 shall not be

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[297] Proposed Rule, 85 FR at 973; Guidance, 78 FR 45325.

[298] 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).

deemed an MSP unless its swap positions exceed one of several thresholds.[299] 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.[300] The Commission also adopted interpretive guidance stating that, for purposes of the MSP analysis, an entity's swap positions are 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").[301]

The Commission is now adopting rules to address the cross-border application of the MSP thresholds to the swap positions of U.S. and non-U.S. persons.[302] Applying CEA section 2(i) and principles of international comity, the Final Rule identifies when a potential MSP's cross-border swap positions apply toward the MSP thresholds and when they may be properly excluded. As discussed below, whether a potential MSP includes a particular swap in its MSP threshold calculations depends on how the entity and its counterparty are classified (*e.g.*, U.S. person, SRS, etc.) and, in some cases, the jurisdiction in which a non-U.S. person is regulated.[303] The Final Rule's approach for the

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[299] 17 CFR 1.3, Major swap participant, paragraph (1). *See generally* Entities Rule, 77 FR 30596.

[300] 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").

[301] *Id.* at 30689.

[302] Final § 23.23(c).

[303] As indicated above, for purposes of the Final Rule, an "Other Non-U.S. Person" refers to a non-U.S. person that is neither a Guaranteed Entity nor an SRS.

cross-border application of the MSP thresholds is similar to the approach described above for the SD threshold.

A. *U.S. Persons*

The Commission is adopting, as proposed, the requirement that a U.S. person include all of its swap positions in its MSP registration threshold calculations without exception.[304] The Commission did not receive comments regarding this requirement. As discussed in the context of the Final Rule's approach to applying the SD de minimis registration threshold, by 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.[305] 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 Final Rule, as discussed in more detail below, whether a non-U.S. person includes a swap position in its MSP threshold calculations depends on its status, the status of its counterparty, or the characteristics of the swap. Specifically, the Final Rule requires 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 is required to count all swap positions with a U.S. person, except for swaps conducted through a foreign branch of a registered

[304] Final § 23.23(c)(1); Proposed Rule, 85 FR at 974, 1004.

[305] *See supra* section III.A; Proposed Rule, 85 FR at 974.

U.S. SD. Subject to an exception, the Final Rule also requires an Other Non-U.S. Person to count all swap positions if the counterparty to such swaps is a Guaranteed Entity.[306]

1. Swaps by a Significant Risk Subsidiary

The Commission proposed to require an SRS to include all of its swap positions in its MSP threshold calculations.[307]

IIB/SIFMA recommended that the Commission not adopt the proposal, asserting that absent a guarantee or other form of direct risk transfer to a U.S. person, a foreign subsidiary does not present sufficiently "direct" risk to the United States to justify extraterritorial application of the MSP registration requirement under section 2(i). IIB/SIFMA stated that permitting foreign subsidiaries to transact in swaps without registering as MSPs also would not create a substantial regulatory loophole, as there is no evidence of sufficiently substantial non-dealing swap activity occurring in foreign subsidiaries at present when SRSs are not subject to MSP registration (just as there are no U.S. persons currently registered as MSPs).

After considering the comment, the Commission is adopting this aspect of the cross-border application of the MSP registration thresholds as proposed.[308] As noted in section II.D, the 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 IHC or subject to comparable capital and margin rules, raises the

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[306] As discussed in sections II.C and III.B, *supra*, 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.

[307] Proposed § 23.23(c)(1); Proposed Rule, 85 FR at 974-975, 1004.

[308] Final § 23.23(c)(1).

concerns intended to be addressed by the Dodd-Frank Act requirements addressed by the Final Rule, regardless of the U.S. person status of its counterparty. Further, 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 SRSs to avoid application of the Dodd-Frank Act MSP requirements. Allowing swaps entered into by SRSs, which have the potential to affect 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 Final Rule. Applying the same standard to similar swap positions helps to limit those incentives and regulatory implications.[309] Additionally, the SRS definition already includes a carve-out for affiliates of U.S. BHCs and IHCs. This approach allows for streamlined application of the rule, and the comment letters have not identified specific problems caused by applying the same standard to similar swap positions.

In addition, a person's status as an SRS is determined at the entity level and, thus, an SRS is required to include in its MSP threshold calculations the swap positions of its operations that are part of the same legal person, including those of its branches.[310]

For added clarity, the Commission also notes that an Other Non-U.S. Person is not be required to include swap positions entered into with an SRS in its MSP threshold calculations, unless the SRS is also a Guaranteed Entity and no other exception applies.

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[309] Proposed Rule, 85 FR at 974-975.

[310] *Id.*

2. Swap Positions with a U.S. Person

The Commission proposed to require an Other Non-U.S. Person to count toward its MSP registration thresholds swap positions where the counterparty is a U.S. person, other than swaps with a foreign branch of a registered U.S. SD if such swaps are conducted through a foreign branch of such registered SD.[311]

IIB/SIFMA supported this approach, stating that it is consistent with the Guidance, except that it does not require that swaps with a foreign branch of a registered SD be subject to daily variation margin in order to be excluded from an Other Non-U.S. Person's MSP registration thresholds. IIB/SIFMA noted that this was appropriate because the Dodd-Frank Act's margin requirements independently impose variation margin requirements on SDs where appropriate. Further, they stated that the change removes the complexity of non-U.S. persons having to determine their own "financial entity" status in order to evaluate whether variation margin was required now that the uncleared swap margin rules use a slightly different "financial end user" definition.

After considering this comment, the Commission is adopting this aspect of the cross-border application of the MSP registration thresholds as proposed.[312] Generally, a potential MSP must include in its MSP threshold calculations 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 and significant adverse effect on a U.S. person and, by virtue

[311] Proposed § 23.23(c)(2)(i); Proposed Rule, 85 FR at 975, 1004.

[312] Final § 23.23(c)(2)(i).

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.[313]

The Final Rule's approach in allowing a non-U.S. person to exclude swap positions conducted through a foreign branch of a registered SD counterparty is consistent with the approach described in section III.B.2 for cross-border treatment with respect to SDs.[314] In this regard, a swap conducted through a foreign branch of a registered SD triggers certain Dodd-Frank Act transactional requirements (or comparable requirements), particularly margin requirements, and therefore mitigates concern that this exclusion could be used to engage in swap activities outside the Dodd-Frank Act regime.

Accordingly, the Commission has determined that it is appropriate and consistent with section 2(i) of the CEA to allow a non-U.S. person, which is not a Guaranteed Entity or SRS, to exclude from its MSP threshold calculations any swaps conducted through a foreign branch of a registered SD counterparty. The Commission recognizes that the Guidance provided 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.[315] The Final Rule does not include such a requirement because the foreign branch of the registered SD is nevertheless 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

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[313] Proposed Rule, 85 FR at 975.

[314] *Id.*

[315] Guidance, 78 FR at 45324-45325.

counterparty 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.[316]

In response to a request for comment,[317] IIB/SIFMA supported not requiring a U.S. branch of a non-U.S. banking organization to include all of its swap positions in its MSP calculation as if they were swaps entered into by a U.S. person or to require an Other Non-U.S. Person to include in its MSP calculation dealing swaps conducted through such a branch. IIB/SIFMA stated that swaps between a U.S. branch and an Other Non-U.S. Person do not present risks to the United States that would justify applying the Commission's MSP requirements. Consistent with the Proposed Rule, the Commission has determined not to require a U.S. branch to include swaps with Other Non-U.S. Persons in its MSP threshold calculations as if they were swaps entered into by a U.S. person. Similarly, the Final Rule does not require an Other Non-U.S. Person to include in its MSP calculation dealing swaps booked in a U.S. branch.

3. Guaranteed Swap Positions

(i) Swap Positions Entered into By a Guaranteed Entity

The Commission proposed to require a non-U.S. person to include in its MSP calculation each swap position with respect to which it is a Guaranteed Entity.[318] No comments were received regarding this aspect of the Proposed Rule, and the Commission

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[316] *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.

[317] Proposed Rule, 85 FR at 977.

[318] Proposed § 23.23(c)(2)(ii); Proposed Rule, 85 FR at 975, 1004.

is adopting this aspect of the cross-border application of the MSP registration thresholds as proposed.[319]

As explained in the context of the SD de minimis threshold calculation, the Commission believes that the swap positions of a Guaranteed Entity 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.[320] As a result of the guarantee, the U.S. guarantor generally bears risk arising out of the swap as if it had entered into the swap directly. Absent the guarantee from the U.S. person, a counterparty may choose not to enter into the swap or may not do so on the same terms. Treating Guaranteed Entities differently from U.S. persons could also create a substantial regulatory loophole, allowing transactions that have a similar connection to or effect 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.

(ii) Swaps Positions Entered into With a Guaranteed Entity

The Commission also proposed to require an Other Non-U.S. Person to count toward its MSP registration thresholds swap positions with a counterparty that is a Guaranteed Entity, except when the counterparty is registered as an SD.[321]

IIB/SIFMA supported this approach, stating that it is consistent with the Guidance, except that it does not require that swaps with a Guaranteed Entity be subject to daily variation margin in order to be excluded from an Other Non-U.S. Person's MSP

[319] Final § 23.23(c)(2)(ii).

[320] *See supra* section III.B.3.i; Proposed Rule, 85 FR at 975.

[321] Proposed § 23.23(c)(2)(iii); Proposed Rule, 85 FR at 975-976, 1004.

registration thresholds. IIB/SIFMA noted that this was appropriate because the Dodd-Frank Act's margin requirements independently impose variation margin requirements on SDs where appropriate. Further, they stated that the change removes the complexity of non-U.S. persons having to determine their own "financial entity" status in order to evaluate whether variation margin was required now that the uncleared swap margin rules use a slightly different "financial end user" definition.

The Commission is adopting as proposed the requirement that a non-U.S. person must count swap positions with a Guaranteed Entity counterparty, except when the counterparty is registered as an SD.[322] 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 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 benefits from a guarantee from a U.S. person. Therefore, in order to avoid creating a substantial regulatory loophole, the Commission has determined that swap positions of a non-U.S. person with a counterparty whose obligations under the swaps are guaranteed by a U.S. person must receive the same treatment as swap positions with a U.S. person.[323]

However, similar to the discussion regarding SDs in section III.B.3.ii, where an Other Non-U.S. Person enters into a swap with a Guaranteed Entity that is a registered

[322] Final § 23.23(c)(2)(iii). The MSP provision does not include an exception for swap positions with non-U.S. persons guaranteed by a non-financial entity, or for swap positions with a Guaranteed Entity where such Guaranteed Entity is itself below the SD de minimis threshold under paragraph (4)(i) of the "swap dealer" definition in § 1.3 and is affiliated with a registered SD, similar to the carve-outs in the SD provision. *See* Final § 23.23(b)(2)(iii)(B) and (C); *supra* section III.B.3.ii.

[323] Proposed Rule, 85 FR at 975-976.

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, 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.[324] In addition, a non-U.S. person's swap positions with a Guaranteed Entity that is an SD are 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 has determined that the non-U.S. person need not count such a swap position toward its MSP thresholds.[325]

C. Attribution Requirement

In the Entities Rule, the Commission and the SEC provided a joint interpretation that an entity's swap positions in general are 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 is required in the absence of recourse.[326] Even in the presence of recourse, however, attribution of a person's swap positions to a parent, other affiliate, or guarantor is not necessary if the person is already subject to capital regulation

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[324] *See* 17 CFR 23.600(c)(4)(ii). *See also* 17 CFR 23.600(c)(1)(i).

[325] Proposed Rule, 85 FR at 975-976.

[326] Entities Rule, 77 FR at 30689.

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).[327]

The Commission proposed 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.[328] Specifically, the Commission stated 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. The Commission stated that even in the presence of a guarantee, attribution would not be required if the entity that entered into the swap directly is subject to capital regulation by the Commission or the SEC or is regulated as a bank in the United States.[329] Additionally, the Commission invited comment on whether it should modify its interpretation with regard to the attribution requirement to provide that attribution of a person's swap positions to a 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.[330]

IIB/SIFMA stated that the Guidance clarified that the exception for entities subject to capital regulation also includes entities subject to non-U.S. 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 (*i.e.*, Basel compliant capital

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[327] *Id.*

[328] Proposed Rule, 85 FR at 976. *See* SEC Cross-Border Rule, 79 FR at 47346-47348.

[329] Proposed Rule, 85 FR at 976.

[330] *Id.* at 977.

standards and oversight by a G20 prudential supervisor). Therefore, IIB/SIFMA recommended that the attribution requirement in the MSP threshold context should exclude entities subject to Basel compliant capital standards and oversight by a G20 prudential supervisor, as those entities should pose no higher risk than entities subject to capital regulation by the Commission, SEC, or a prudential regulator.

The Commission is adopting the interpretation of the attribution requirement as discussed in the Proposed Rule, with a clarification. The Commission has determined that, in addition to entities that are subject to capital regulation by the Commission, SEC, or U.S. prudential regulators, the attribution requirement in the MSP threshold context also excludes entities subject to Basel compliant capital standards and oversight by a G20 prudential supervisor. As noted by IIB/SIFMA in response to a request for comment, this approach is consistent with the Guidance, and is recommended because those entities pose no higher risk than entities subject to capital regulation by the Commission, SEC, or a prudential regulator. The Commission has further determined that the swap positions of an entity that is required to register as an MSP, or whose MSP registration is pending, are not subject to the attribution requirement.

Generally, if a guarantee is present, however, and the entity being guaranteed is not subject to capital regulation (as described above), whether the attribution requirement applies depends 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 attributes 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 finds 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.[331]

A non-U.S. person attributes 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.[332] In this regard, the Commission finds 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.

In addition, the Commission believes that entities subject to a guarantee are able to enter into significantly more swap positions (and take on significantly more risk) as a result of the guarantee than they can 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 has determined that a non-U.S. person must 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.

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[331] *Id.* at 976. *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).

[332] As noted above, the term Guaranteed Entity is limited to entities that are guaranteed by a U.S. person.

D. *Certain Exchange-Traded and Cleared Swaps*

Consistent with its approach for SDs, the Commission proposed to 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,[333] if such swap is also cleared through a registered or exempt DCO.[334]

As discussed in section III.D in connection with the cross-border application of the SD registration threshold, as compared to the Proposed Rule, IIB/SIFMA, JFMC/IBAJ, JBA, and JSCC advocated for expansion of this exception, while Better Markets stated that the proposed exception should be narrowed.

Consistent with the cross-border application of the SD registration threshold, the Commission is adopting this exception as proposed.[335] 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 does not have the necessary information about its counterparty to determine whether the swap position should be included in its MSP calculation. The Commission has determined that in this case the swap position should be excluded altogether due to these practical difficulties.[336] However, the exception is limited to Other Non-U.S. Persons since, as discussed,

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[333] The Commission considers the 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.

[334] Proposed § 23.23(d); Proposed Rule, 85 FR at 976, 1004.

[335] Final § 23.23(d).

[336] *See* Proposed Rule, 85 FR at 976.

Guaranteed Entities and SRSs have to count all of their swap positions towards the threshold, so the practical obstacles that would challenge Other Non-U.S. Persons are not relevant for Guaranteed Entities and SRSs.

The Final Rule expands the exception as it appeared in the Guidance 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 appropriate governmental authorities in the SEF or DCO's home country.[337] The policy rationale for providing relief to swap positions 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 is subject to comprehensive regulation that is comparable to that applicable to registered SEFs and DCOs.

The Commission is not at this time expanding the exception to allow an Other Non-U.S. Person to exclude swap positions executed anonymously on an exchange and which are subsequently cleared, regardless of whether the exchange and clearing organization are registered or exempt from registration with the Commission. Commenters argued that if the Other Non-U.S. Person's original counterparty was a U.S. person, the Commission's SEF and DCO registration requirements would independently require the trading venue and clearing organization to register with the Commission or obtain an exemption from registration. While guidance from DMO has suggested that

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

this might be the case with respect to SEFs and DCMs,[338] the Commission has not taken a formal position on whether registration of a SEF or DCM is required where a U.S. person participates on the trading facility, and has stated that it will do so in the future.[339] The Commission may consider expanding the exception pending other amendments to the SEF/DCO regulations.

In response to comments that anonymity should not be required, the Commission proposed this exception (and included it in the Guidance) because when a trade is entered into anonymously on an exchange, 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.[340] Therefore, these practical difficulties justify exclusion of the swap position altogether. However, if the identity of the counterparty is known to be a U.S. person, then the Other Non-U.S. Person should be seen to be participating in the U.S. swap market. Thus, the Commission has determined that such a non-U.S. person should count such swap positions towards its MSP calculation as otherwise required. As stated above, where the U.S. person status of a counterparty is known to the non-U.S.

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[338] Division of Market Oversight Guidance on Application of Certain Commission Regulations to Swap Execution Facilities, at 2 n.8 (Nov. 15, 2013) ("[DMO] expects that a multilateral swaps trading platform located outside the United States that provides U.S. persons . . . with the ability to trade or execute swaps on or pursuant to the rules of the platform, either directly or indirectly through an intermediary, will register as a SEF or DCM.").

[339] *See* Swap Execution Facilities and Trade Execution Requirement, 83 FR 61946, 61961 n.106 ("[T]he Commission learned that many foreign multilateral swaps trading facilities prohibited U.S. persons and U.S-located persons from accessing their facilities due to the uncertainty that the guidance created with respect to SEF registration. The Commission understands that these prohibitions reflect concerns that U.S. persons and U.S.-located persons accessing their facilities would trigger the SEF registration requirement. . . . [T]he Commission expects to address the application of CEA section 2(i) to foreign multilateral swaps trading facilities, including foreign swaps broking entities, in the future.").

[340] Proposed Rule, 85 FR at 976; Guidance, 78 FR 45325.

person, the Commission sees no reason to treat a cleared swap differently in the cross-border context than such swap position is treated in the domestic U.S. context.

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 (as that term was used in the Guidance) when entering into ANE Transactions.[341]

In the Proposed Rule the Commission stated that, based on the Commission's consideration of its experience under the Guidance, the comments it had received pursuant to the ANE Request for Comment,[342] 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 had determined that ANE Transactions will not be considered a relevant factor for purposes of applying the Proposed Rule.[343] Therefore, under the Proposed Rule, all foreign-based swaps entered into between a non-U.S. swap entity and a non-U.S. person would be treated the same regardless of whether the swap is an ANE Transaction. The Commission further noted that, to the extent the Proposed Rule is finalized, this treatment would effectively supersede the ANE Staff Advisory with

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[341] *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. As discussed in section VI.A, *infra*, the Transaction-Level Requirements are: (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.

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

[343] *See* Proposed Rule, 85 FR at 977-979.

respect to the application of the group B and C requirements (discussed in sections VI.A.2 and VI.A.3 below) to ANE Transactions.

With respect to its experience, the Commission noted 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.[344] The Commission also noted that in the intervening period, the Commission had not found a negative effect on either its ability to effectively oversee non-U.S. swap entities, or the integrity and transparency of U.S. derivatives markets.

Noting its interest in international comity, the Commission observed that ANE Transactions involve swaps between non-U.S. persons, and thus the Commission considered whether the U.S. aspect of ANE Transactions should override its general view that such transactions should qualify for the same relief provided under the Proposed Rule (and the Guidance) for swaps between certain non-U.S. persons (*e.g.*, an exception from compliance with Transaction-Level Requirements under the Guidance and group B and C requirements under the Proposed Rule, as discussed below). The Commission expressly recognized that a person that, in connection with its dealing activity, engages in market-facing activity using personnel located in the United States is 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 considered the extent to which the underlying

[344] Specifically, non-U.S. persons that are neither guaranteed nor conduit affiliates, as described in the Guidance.

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 a determination of the extent to which the Dodd-Frank Act swap requirements would apply to ANE Transactions.

The Commission noted that the consequences of not applying 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,[345] and § 180.1.[346] 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 noted that, in most cases, non-U.S. 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

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[345] 7 U.S.C. 9(1).

[346] 17 CFR 180.1.

most of the major swap trading centers have implemented similar risk mitigation requirements.[347]

With respect to market distortion, the Commission gave weight to comments submitted in response to the ANE Request for Comment, who 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 to have to interpret and apply what the commenters considered a challenging ANE analysis, thereby potentially increasing market fragmentation.[348]

The Commission also gave 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 recognized 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, where the risk lies outside the U.S. financial system, the Commission recognized the greater supervisory interest of the authorities in the home jurisdictions of the non-U.S. persons. The Commission also noted that no major swap regulatory jurisdiction applies its regulatory regime to U.S. entities engaging in ANE Transactions within its territory.

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[347] *See* 2019 FSB Progress Report, Table M.

[348] Proposed Rule, 85 FR at 977.

In light of the foregoing, the Commission 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 market fragmentation and disruption, the Commission's respect for the regulatory interests of the foreign jurisdictions where the actual financial risks of ANE Transactions primarily 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, outweighed the Commission's regulatory interest in applying its swap requirements to ANE Transactions differently than such were otherwise proposed to be applied to swaps between Other Non-U.S. Persons. The Commission invited comment on all aspects of the proposed treatment of ANE Transactions.

B. Summary of Comments

Neither Better Markets nor AFR supported the Commission's determination to disregard ANE Transactions and commented that the Commission should not permit U.S.-located personnel to arrange, negotiate, or execute swaps on behalf of the non-U.S. affiliates of U.S. BHCs (and others) without being subject to the full panoply of U.S. regulations. Better Markets stated its belief that any such policy facilitates avoidance, if not evasion, and regulatory arbitrage. Better Markets specifically disputed the Commission's contention in the Proposed Rule that "the financial risk of the [ANE] transactions [only] lie outside of the United States," which Better Markets contends is demonstrably untrue and conflicts with the Commission's own views elsewhere in the Proposed Rule, presumably referring to the proposed treatment of swaps of non-U.S.

persons with Guaranteed Entities and SRSs, which are also non-U.S. persons that the Commission nevertheless proposed generally would be subject to certain Dodd-Frank Act requirements.[349]

On the other hand, AIMA, Chatham Financial, CS, IIB/SIFMA, ISDA, and JFMC/IBAJ supported the Commission's decision in the Proposed Rule to only apply anti-fraud and anti-manipulation rules to ANE Transactions, agreeing in various respects with the Commission's analysis that:

1. ANE Transactions do not present direct financial risk to the United States;
2. The Commission's anti-fraud and anti-manipulation rules that would remain applicable would mitigate potential concerns associated with any potential misconduct occurring in connection with ANE Transactions and any other conduct subject to the jurisdiction of the CEA;
3. Most ANE Transactions are expected to be subject to foreign regulatory requirements similar to the Commission's own, unlike at the time of the adoption of the Guidance; and
4. Applying the Commission's rules to ANE Transactions would likely result in disruptive and unnecessary market fragmentation as transactions ordinarily arranged, negotiated, or executed by U.S. personnel would shift to non-U.S. locations, resulting in decreased Commission oversight.

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[349] As discussed below, the Final Rule excepts certain transactions with "SRS End-Users" from the Group B requirements, excepts certain transactions with Guaranteed Entities and SRSs from the Group C requirements, and provides a limited exception from the Group B requirements for transactions entered into by Guaranteed Entities and SRSs that are swap entities with certain non-U.S. persons. *See infra* sections VI.B.3 and VI.B.5.

Commenting on specific aspects of the Commission's proposed treatment of ANE Transactions, AIMA encouraged the CFTC to adopt the SEC's approach and require counting of ANE Transactions toward the SD registration threshold and to apply reporting requirements to ensure that a baseline level of transparency is maintained.

IIB/SIFMA recognized that the Proposed Rule's approach to ANE Transactions would deviate from that taken by the SEC, but argued that this deviation is justified. They argued that the relationship of the security-based swap market to the cash securities markets, and Congress's decision to define security-based swaps as "securities," presents some justification for the SEC to apply a test for use of U.S. jurisdictional means to conduct security-based swap business that is similar to the test that applies in connection with existing, pre-Dodd-Frank Act securities broker-dealer regulation, while no similar justification applies in connection with swaps regulation by the Commission, as the swaps market generally trades independently of the U.S. futures market, and Congress did not define swaps to be a type of futures contract.

IIB/SIFMA, CS, JFMC/IBAJ, and ISDA also commented on the continuing viability of the ANE Staff Advisory. These commenters stated that, currently, ANE Transactions are subject to the ANE Staff Advisory and related ANE No-Action Relief, noting that, if adopted, the Proposed Rule would supersede the ANE Staff Advisory, but only with respect to those requirements covered by the Proposed Rule. These commenters noted that certain other Commission requirements – mandatory clearing, mandatory trade execution, and real-time public reporting – would remain subject to the ANE Staff Advisory and related ANE No-Action Relief, pending further Commission action. To achieve a coherent, Commission-driven ANE Transaction policy, these commenters all requested that the Commission immediately direct staff to withdraw the ANE Staff Advisory (which, in their view, would render the ANE No-Action Relief moot).

ISDA noted that the ANE No-Action Relief was issued two weeks after the ANE Staff Advisory and that market participants have operated under this relief for almost seven years. ISDA argued that, during this time, to ISDA's knowledge, there have been no regulatory concerns associated with these transactions that would warrant a change in course. Thus, should the Commission decide to switch gears and apply clearing, trading, and real-time reporting requirements to ANE Transactions, market participants would incur significant compliance costs without commensurate benefit to the Commission's regulatory oversight.

Although Citadel agreed that the Commission should apply its jurisdiction over ANE Transactions in a targeted manner, taking into account principles of international comity, as well as its supervisory interests and statutory objectives, Citadel argued that because the Commission's relevant statutory objectives include not only mitigating systemic risk, but also increasing transparency, competition, and market integrity, the Commission should, at a minimum, apply regulatory and public reporting requirements to ANE Transactions. AIMA also encouraged the Commission to apply reporting requirements to ensure that a baseline level of transparency is maintained. Citadel stated that application of reporting requirements to these transactions would enable the Commission to better monitor for disruptive trading practices and provide the necessary data regarding overall market trading activity to allow the Commission to evaluate market trends and accurately assess the effect of other reforms implemented in the swaps market.

Stating that ANE Transactions could account for a material portion of total swap dealing activity in the United States, Citadel claimed that market transparency in EUR interest rate swaps for U.S. investors has been greatly reduced based on data showing that, following issuance of the ANE No-Action Relief, interdealer trading activity in EUR interest rate swaps began to be booked almost exclusively to non-U.S. entities, a fact pattern that Citadel believes is "consistent with (although not direct proof of) swap dealers strategically choosing the location of the desk executing a particular trade in order to avoid trading in a more transparent and competitive setting." Citadel further noted that applying regulatory and public reporting requirements to ANE Transactions would be consistent with the SEC's approach.

C. Commission Determination

Having considered the comments received, the Commission's consideration of its experience under the Guidance, 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, consistent with its rationale expressed in the Proposed Rule summarized above, ANE Transactions will not be considered a relevant factor for purposes of applying the Final Rule.

Regarding the many comments and suggestions received regarding whether the Commission should withdraw the ANE Staff Advisory and related ANE No-Action Relief and extend its proposed treatment of ANE Transactions to requirements in addition to the group B and group C requirements, in 2014, subsequent to the publication of the

ANE Staff Advisory, the Commission, citing the complex legal and policy issues raised by the statements in the ANE Staff Advisory, requested comments on whether the Transaction-Level Requirements should apply to swap transactions between certain non-U.S. SDs and non-U.S. counterparties that are "arranged, negotiated, or executed" by the SDs' personnel or agents located in the United States.[350] The Commission did not follow-up on the request for comment. In this rulemaking, the Commission is addressing the issue with respect to the group B and group C requirements; the Commission intends to address the issue with respect to the remaining Transaction-Level Requirements (the "Unaddressed TLRs") in connection with future cross-border rulemakings relating to such requirements. Until such time, the Commission will not consider, as a matter of policy, a non-U.S. swap entity's use of their personnel or agents located in the United States to "arrange, negotiate, or execute" swap transactions with non-U.S. counterparties for purposes of determining whether Unaddressed TLRs apply to such transactions. As part of any such rulemaking, the Commission expects to first engage in fact-finding to determine the extent to which ANE Transactions raise policy concerns that are not otherwise addressed by the CEA or Commission regulations. In this connection, DSIO is withdrawing the ANE Staff Advisory and, together with the Division of Clearing and Risk and DMO, is withdrawing the ANE No-Action Relief and granting certain non-U.S. SDs no-action relief with respect to the applicability of the Unaddressed TLRs to their transactions with non-U.S. counterparties that are arranged, negotiated, or executed in the United States.

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[350] *See* ANE Request for Comment, *supra* note 12.

The Commission will take AIMA and Citadel's comments regarding the advisability of applying the Commission's regulatory and real-time reporting requirements to ANE Transactions under advisement when considering the cross-border application of those requirements in a future rulemaking.

With respect to AFR and Better Markets' contentions that the Commission should not permit derivatives dealers located within the U.S. to engage in transactions using U.S. personnel on U.S. soil without being subject to U.S. law, the Proposed Rule clearly stated that the Commission recognized that a person that, in connection with its dealing activity, engages in market-facing activity using personnel located in the United States is conducting a substantial aspect of its dealing business in the United States and is subject to U.S. law. But, because the transactions involve two non-U.S. persons, and the financial risk of the transactions lies primarily outside the United States, the Commission also recognized that it must consider 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 a determination of the extent to which the Dodd-Frank Act swap requirements should apply to ANE Transactions.

With respect to AIMA's comment encouraging the CFTC to adopt the SEC's approach with respect to ANE Transactions by requiring counting of ANE Transactions toward the SD registration threshold, the Commission sees little value in requiring counting of ANE Transactions when, if such counting resulted in SD registration, such ANE Transactions would not be subject to most of the SD requirements. ANE Transactions by definition are swaps between non-U.S. persons, the risk of which lies primarily outside of the U.S., and which, in accordance with the Commission's determination above and the regulatory exceptions discussed immediately below, are generally excepted from the group B and C requirements.

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

As discussed in the Proposed Rule, 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.[351] These requirements are designed to reduce systemic risk, increase counterparty protections, and increase market efficiency, orderliness, and transparency.[352] Consistent with the Guidance,[353] SDs and MSPs (whether or not U.S. persons) are subject to all of the 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.

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[351] *See* Proposed Rule, 85 FR at 979-980.

[352] *See, e.g.*, Entities Rule, 77 FR at 30629, 30703.

[353] *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.

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 providing exceptions from, and a substituted compliance process for, certain regulations applicable to registered SDs and MSPs, as appropriate.[354] Further, the Final Rule creates 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

As discussed in the Proposed Rule, the Guidance applied a bifurcated approach to the classification of certain regulatory requirements applicable to SDs and MSPs, based on whether the requirement 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").[355]

The Guidance categorized the following regulatory requirements as ELRs: (1) capital adequacy; (2) chief compliance officer ("CCO"); (3) risk management; (4) swap data recordkeeping; (5) swap data repository ("SDR") reporting; and (6) large trader reporting.[356] The Guidance further divided ELRs into two subcategories.[357] The first category of ELRs includes: (1) capital adequacy; (2) CCO; (3) risk management; and (4)

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[354]As noted in the Proposed Rule, the Commission intends to separately address the cross-border application of Title VII requirements not addressed in the Final Rule (*e.g.*, capital adequacy, clearing and swap processing, mandatory trade execution, swap data repository reporting, large trader reporting, and real-time public reporting) (hereinafter, the "Unaddressed Requirements"). In that regard, the Commission notes that it adopted capital adequacy and related financial reporting requirements for SDs and MSPs at its open meeting on July 22, 2020.

[355] *See, e.g.*, Guidance, 78 FR at 45331.

[356] *See, e.g.*, *id.*

[357] *See, e.g.*, *id.*

certain swap data recordkeeping requirements[358] ("First Category ELRs").[359] 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 (4); and (3) large trader reporting ("Second Category ELRs").[360]

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.[361] As with the ELRs, the Guidance similarly subdivided TLRs into two subcategories.[362] The Commission determined that all TLRs, other than external business conduct standards, address risk mitigation and market transparency.[363] 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."[364] 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

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[358] Swap data recordkeeping under 17 CFR 23.201 and 23.203 (except certain aspects of swap data recordkeeping relating to complaints and sales materials).

[359] *See, e.g.*, Guidance, 78 FR at 45331.

[360] *See, e.g.*, *id.*

[361] *See, e.g.*, *id.* at 45333.

[362] *See, e.g.*, *id.*

[363] *See, e.g.*, *id.*

[364] *See, e.g.*, *id.*

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.[365]

To avoid confusion that may have arisen from using the ELR/TLR classification in the Proposed Rule, given that the Proposed Rule did not address the same set of Commission regulations as the Guidance, the Commission proposed 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. The Commission requested comment on the group A, group B, and group C requirement classifications and on whether any modifications should be made to the set of requirements in such groups.[366]

The Commission received several comments on its proposed use of the group A, group B, and group C requirements classifications. IIB/SIFMA and JFMC/IBAJ generally supported the Proposed Rule's classification of swap entity requirements. However, IIB/SIFMA requested that the Commission expand and clarify such categorization in certain respects (discussed in the relevant sections below) to align the cross-border application of the Commission's requirements with the policy objectives for those requirements. AIMA stated its belief that any swap involving a non-U.S. person (even where its counterparty is a U.S. person) should also be able to use substituted compliance and encouraged the CFTC to review the group B and group C requirements with this approach in mind, but did not provide any specific recommended changes to those classifications. IATP stated that it was not clear which set of regulations were

[365] *See, e.g.*, *id.* at 45337-45338.

[366] Proposed Rule, 85 FR at 982.

covered by the Proposed Rule that are not covered by the Guidance and that, without a comparative summary of the different set of regulations covered by each, there is no grounds to judge readily why the Commission proposed to abandon the readily understood “entity level” and “transaction level” requirement classifications to compare for granting substituted compliance to foreign regulatory regimes.

After considering the comments, the Commission continues to believe that classifying certain of its regulations as group A, group B, and group C requirements is appropriate and helpful for purposes of determining the availability of certain exceptions from, and/or substituted compliance for, such regulations.[367] The proposed and final group A, group B, and group C requirements are discussed below.

1. Group A Requirements

(i) Proposed Rule

The Commission proposed that the group A requirements would include: (1) CCO; (2) risk management; (3) swap data recordkeeping; and (4) antitrust considerations. Specifically, under the Proposed Rule, the group A requirements consisted of 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.[368] As discussed in the Proposed Rule, the Commission believes that the group A requirements would be impractical to apply only to specific transactions or counterparty relationships and are most effective when applied consistently across the entire enterprise, noting that they ensure that swap entities

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[367] With respect to AIMA’s comment, the Commission notes that the Proposed Rule provided a summary of all of the requirements addressed by the Guidance and which requirements were addressed in the Proposed Rule.

[368] 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.

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. Further, the Commission noted that, together with other Commission requirements, the proposed group A requirements constitute an important line of defense against financial, operational, and compliance risks that could lead to a firm's default; and, further, that 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 stated that it has strong supervisory interests in ensuring that swap entities (whether domestic or foreign) are subject to the group A requirements or comparably rigorous standards.[369]

Each of the proposed group A requirements is discussed in more detail below.

(a) Chief compliance officer

Section 4s(k) of the CEA requires that each SD and MSP designate an individual to serve as its CCO and specifies certain duties of the CCO.[370] Pursuant to section 4s(k), the Commission adopted § 3.3,[371] which requires SDs and MSPs to designate a CCO responsible for administering the firm's compliance 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

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[369] *See* Proposed Rule, 85 FR at 980-981.

[370] 7 U.S.C. 6s(k).

[371] 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; 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).

registrant's compliance policies and activities. The CCO function is an integral element of a firm's risk management and oversight, as well as the Commission's effort to foster a strong culture of compliance within SDs and MSPs.

(b) 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.[372] The Commission implemented these provisions in §§ 23.600, 23.601, 23.602, 23.603, 23.605, and 23.606.[373] The Commission also adopted § 23.609,[374] which requires certain risk management procedures for SDs or MSPs that are clearing members of a DCO.[375] 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.

(c) 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.[376] 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

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[372] 7 U.S.C. 6s(j).

[373] 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).

[374] 17 CFR 23.609.

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

[376] 7 U.S.C. 6s(f)(1)(B).

complete audit trail for comprehensive trade reconstructions.[377] 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.[378] 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."[379]

Pursuant to these provisions, the Commission promulgated final rules that set forth certain reporting and recordkeeping requirements for SDs and MSPs.[380] Specifically, §§ 23.201 and 23.203[381] require SDs and MSPs to keep records including complete transaction and position information for all swap activities (e.g., 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.[382] Such records must include, among other things, a record of each complaint received by the SD or MSP concerning any partner, member, officer, employee, or agent,[383] as well as all marketing and sales presentations, advertisements, literature, and communications.[384] Commission regulation 23.203[385] requires, among other things, that records (other than swap data reported in accordance

[377] 7 U.S.C. 6s(g)(1) and (4).

[378] 7 U.S.C. 6s(f)(1).

[379] 7 U.S.C. 6s(h)(1). *See* 7 U.S.C. 6s(h)(3).

[380] *See* Final SD and MSP Recordkeeping, Reporting, and Duties Rule, 77 FR 20128.

[381] 17 CFR 23.201 and 203.

[382] 17 CFR 23.201(b).

[383] 17 CFR 23.201(b)(3)(i).

[384] 17 CFR 23.201(b)(4).

[385] 17 CFR 23.203.

with part 45 of the Commission's regulations[386]) be maintained in accordance with § 1.31.[387] 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 recordkeeping period.[388]

(d) 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.[389] The Commission promulgated this requirement in § 23.607(a)[390] 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.[391]

(ii) Summary of Comments

JFMC/IBAJ and IIB/SIFMA were supportive of the streamlining of the Commission's recordkeeping requirements under § 23.201 as group A requirements (which the Guidance separated into two different subcategories). JFMC/IBAJ also requested the Commission explicitly categorize § 1.31 as a group A requirement in furtherance of the goal of providing legal certainty and streamlining recordkeeping

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[386] 17 CFR 45.

[387] 17 CFR 1.31.

[388] 17 CFR 1.31(b).

[389] 7 U.S.C. 6s(j)(6).

[390] 17 CFR 23.607(a).

[391] 17 CFR 23.607(b).

requirements. IIB/SIFMA requested that the Commission include §§ 1.31 and 45.2 as group A requirements, which they stated would be consistent with categorizing § 23.203 as a group A requirement. IIB/SIFMA also was supportive of including the Commission's antitrust rules (which were not addressed by the Guidance) as a group A requirement.

(iii) Final Rule

After carefully considering the comments, the Commission is adopting the proposed group A requirements and adding § 45.2(a) to the group A requirements to the extent it duplicates § 23.201, as shown in the rule text in this release.[392] The Commission is making this addition to clarify that, to the extent the same substantive recordkeeping requirement is included in both §§ 23.201 and 45.2(a),[393] each is a group A requirement for which substituted compliance may be available, as discussed in section VI.C below.[394]

Regarding the comments to include § 1.31 as a group A requirement, § 1.31 is a general requirement providing maintenance and access requirements for many regulatory records, and not only those required under the group A requirements. Further, to the extent an SD/MSP receives substituted compliance for a group A requirement, such as § 23.203, that incorporates § 1.31's recordkeeping requirements for certain regulatory

[392] Final § 23.23(a)(6).

[393] Commission regulation 23.201 requires, in relevant part, that each SD and MSP keep full, complete, and systematic records, together with all pertinent data and memoranda, of all its swaps activities and its activities related to its business as a SD or MSP. Commission regulation 45.2(a) requires, in relevant part, that each SD and MSP subject to the jurisdiction of the Commission shall keep full, complete, and systematic records, together with all pertinent data and memoranda, of all activities relating to the business of such entity or person with respect to swaps, as prescribed by the Commission.

[394] Similarly, the Commission will view any previously issued comparability determination that allows substituted compliance for § 23.201 to also allow for substituted compliance with § 45.2(a) to the extent it duplicates § 23.201.

records, the Commission's view is that § 1.31 would also not apply to such regulatory records. Therefore, the Commission is declining to include § 1.31 as a group A requirement.

2. Group B Requirements

(i) Proposed Rule

The Commission proposed that the group B requirements would include: (1) swap trading relationship documentation; (2) portfolio reconciliation and compression; (3) trade confirmation; and (4) daily trading records. Specifically, under the Proposed Rule, the group B requirements consist of the requirements set forth in §§ 23.202, 23.501, 23.502, 23.503, and 23.504.[395] As discussed in the Proposed Rule, the group B requirements relate to risk mitigation and the maintenance of good recordkeeping and business practices.[396] The Commission stated that, unlike for the group A requirements, it 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. Therefore, the Commission stated that it can 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.[397]

Each of the proposed group B requirements is discussed in more detail below.

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[395] 17 CFR 23.202, 23.501, 23.502, 23.503, and 23.504.

[396] *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.

[397] *See* Proposed Rule, 85 FR at 981-982.

(a) 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.[398] Pursuant to section 4s(i), the Commission adopted, among other regulations, § 23.504.[399] 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.[400] 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.[401] 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.

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[398] 7 U.S.C. 6s(i).

[399] 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").

[400] 17 CFR 23.504(a)(2) and (c).

[401] 17 CFR 23.504(b).

(b) 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.[402] Pursuant to CEA section 4s(i), the Commission adopted §§ 23.502 and 23.503,[403] which require SDs and MSPs to perform portfolio reconciliation and compression for their swaps.[404] 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.[405] 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.[406] The rule also requires policies and procedures for engaging in such exercises for uncleared swaps with non-SDs and non-MSPs upon request.[407]

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[402] 7 U.S.C. 6s(i).

[403] 17 CFR 23.502 and 503. *See* Final Confirmation, Risk Mitigation, and Documentation Rules, 77 FR 55904.

[404] *See* 17 CFR 23.502 and 503.

[405] For example, the reduced transaction count may decrease operational risk as there are fewer trades to maintain, process, and settle.

[406] *See* 17 CFR 23.503(a).

[407] 17 CFR 23.503(b).

(c) 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.[408] The Commission adopted § 23.501,[409] 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.[410] Timely and accurate confirmation of swaps – together with portfolio reconciliation and compression – is an important post-trade processing mechanism for reducing risks and improving operational efficiency.[411]

(d) Daily trading records

Pursuant to CEA section 4s(g),[412] the Commission adopted § 23.202,[413] 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.[414] Accurate and

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[408] 7 U.S.C. 6s(i).

[409] 17 CFR 23.501. *See* Final Confirmation, Risk Mitigation, and Documentation Rules, 77 FR 55904.

[410] 17 CFR 23.501(a)(1).

[411] 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).

[412] 7 U.S.C. 6s(g).

[413] 17 CFR 23.202. *See* Final SD and MSP Recordkeeping, Reporting, and Duties Rule, 77 FR 20128.

[414] 17 CFR 23.202(b).

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.

(ii) Summary of Comments

IIB/SIFMA stated that they support the Commission's proposed categorization of the group B requirements, but requested that the Commission recategorize its pre-execution daily trading records requirements under § 23.202 as group C requirements instead of group B requirements. IIB/SIFMA asserted that pre-execution information generally has no nexus to the risk management of the swap entity or to the Commission's risk mitigation rules and instead relate to a swap entity's sales practices.

(iii) Final Rule

After carefully considering the comments, the Commission is adopting the group B requirements as proposed.[415] With respect to the request to make pre-execution trading records requirements a group C requirement, accurate and timely records regarding all phases of a swap transaction (including pre-execution trading records) 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. Because these records relate to market integrity (and not only customer protection), the Commission believes the pre-execution trading records requirements should continue to be group B requirements and not be eligible for the exceptions the Final Rule provides from the group C requirements.

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[415] Final § 23.23(a)(7).

3. Group C Requirements

(i) Proposed Rule

Pursuant to CEA section 4s(h),[416] 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.[417] The Commission proposed that the group C requirements would consist of these rules, which are set forth in §§ 23.400 through 23.451.[418] As discussed in the Proposed Rule, broadly speaking, these rules are 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 ("ECP") 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.

As the Commission discussed in the Proposed Rule, the group C requirements 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, the Commission noted its belief that the foreign jurisdictions in which non-U.S. persons and

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[416] 7 U.S.C. 6s(h).

[417] *See* Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 77 FR 9734 (Feb. 17, 2012).

[418] 17 CFR 23.400 – 23.451.

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.[419]

(ii) Summary of Comments

IIB/SIFMA supported the Proposed Rule's categorization of the Commission's external business conduct standards as group C requirements because the approach is consistent with the Guidance, and these requirements focus on counterparty protection. However, IIB/SIFMA requested that the Commission add its rules for elective initial margin segregation to the list of group C requirements.[420] They argued that these rules found in part 23, subpart L (§§ 23.700 – 23.704) ("Subpart L"),[421] like the proposed group C requirements, are largely focused on customer protection rather than risk mitigation.

(iii) Final Rule

After careful consideration of the comments, the Commission is adopting the group C requirements as proposed and adding the requirements of Subpart L as group C requirements, as shown in the rule text in this release.[422]

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[419] *See* Proposed Rule, 85 FR at 982.

[420] As noted in the discussion of the group B requirements, IIB/SIFMA also requested that the Commission recategorize pre-execution daily trading records rules as group C requirements (not group B requirements).

[421] 17 CFR part 23, subpart L.

[422] Final § 23.23(a)(8).

Section 724(c) of the Dodd-Frank Act amended the CEA to add section 4s(l),[423] which addresses segregation of initial margin held as collateral in uncleared swap transactions (*i.e.*, swaps not submitted for clearing on a DCO). Section 4s(l) was implemented in Subpart L, which imposes requirements on SDs and MSPs with respect to the treatment of collateral posted by their counterparties to margin, guarantee, or secure certain uncleared swaps.[424] Specifically, § 23.701 requires, except in those circumstances where segregation is mandatory under the Margin Rules, that a SD/MSP provide notice to its counterparty of its right to have Initial Margin ("IM")[425] provided by it to the SD/MSP segregated in accordance with §§ 23.702 and 23.703.[426] Commission regulations 23.702 and 23.703 provide requirements for segregation and investment of IM where the counterparty elects such segregation,[427] and § 23.704 requires that each SD/MSP report quarterly to each counterparty that does not choose to require IM segregation that the back office procedures of the SD/MSP relating to margin and collateral requirements are in compliance with the agreement of the counterparties.[428]

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[423] 7 U.S.C. 6s(l).

[424] Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy, 78 FR 66621 (Nov. 2013). The Commission later amended Subpart L in light of the Commission's adoption of subpart E of part 23 (Capital and Margin Requirements for Swap Dealers and Major Swap Participants) in January 2016 and the prudential regulators' adoption of similar rules in November 2015 (together, "Margin Rules"), which, among other things, established initial margin requirements applicable to SDs and MSPs. As a result, Subpart L's segregation requirements apply only when the Margin Rules' segregation requirements do not. Further, the Commission understands that counterparties have elected segregation under Subpart L very rarely. *See, e.g.*, Segregation of Assets Held as Collateral in Uncleared Swap Transactions, 84 FR 12894 (Apr. 2019).

[425] "Initial Margin" is defined in § 23.700 for purposes of Subpart L as money, securities, or property posted by a party to a swap as performance bond to cover potential future exposures arising from changes in the market value of the position. 17 CFR 23.700.

[426] 17 CFR 23.701.

[427] 17 CFR 23.702 and 703.

[428] 17 CFR 23.704.

The Commission agrees with IIB/SIFMA that these requirements are focused on customer protection rather than risk mitigation and are appropriately included as group C requirements. In this regard, the Commission notes, specifically, that Subpart L leaves to the discretion of the counterparty to the SD/MSP whether IM is segregated, rather than mandating its segregation, and has largely been superseded by the Margin Rules, which specifically address systemic risk in relation to margin for uncleared swaps.

B. Exceptions from Group B and Group C Requirements

1. Proposed Exceptions, Generally

(i) Proposed Rule

Consistent with section 2(i) of the CEA, the Commission proposed four exceptions from certain Commission regulations for foreign-based swaps in the Proposed Rule.[429]

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

Third, the Commission proposed an exception from the group B requirements for certain foreign-based swaps of foreign branches of U.S. swap entities with certain foreign

[429] *See* Proposed Rule, 85 FR at 982-984.

counterparties, subject to certain limitations, including a quarterly cap on the amount of such swaps ("Limited Foreign Branch Group B Exception").[430]

Fourth, the Commission proposed 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").

While these exceptions each have different eligibility requirements, a common requirement is that they would be available only to foreign-based swaps,[431] as other swaps 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. Further, swap entities that avail themselves of these exceptions for their foreign-based swaps would 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, 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.[432] The Commission also 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.[433]

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[430] This exception was defined as the "Foreign Branch Group B Exception" in the Proposed Rule. The Commission is adding the word "Limited" to the beginning of the defined term, to reflect the conditions that apply to the use of the exception, including the cap on its use in a calendar quarter.

[431] As discussed in section II.I, *supra*, a foreign-based swap means: (1) a swap by a non-U.S. swap entity, except for a swap booked in a U.S. branch; or (2) a swap conducted through a foreign branch.

[432] 17 CFR 180.1.

[433] 17 CFR 23.600.

The Commission requested comments on whether, in light of the Commission's supervisory interests, the proposed exceptions were appropriate or whether they should be broadened or narrowed.[434]

(ii) Summary of Comments

JFMC/IBAJ generally supported the proposed exceptions to the application of group B and C requirements under the Proposed Rule, stating that they believe the exceptions generally strike the right balance in protecting the integrity, safety, and soundness of the U.S. financial system while recognizing the principles of international comity. ISDA stated that it supported the Commission's intent to place non-U.S. swap entities (that are Other Non-U.S. Persons) and foreign branches of U.S. swap entities on equal footing with respect to the cross-border application of certain CFTC requirements, noting that foreign branches of U.S. swap entities are subject to the laws of the foreign jurisdictions in which they operate and, thus, imposing U.S. requirements on these entities results in duplicative regulation—increasing compliance costs, complexity, and inefficiencies. However, JFMC/IBAJ, ISDA, and IIB/SIFMA requested that the Commission expand and clarify the Proposed Rule's exceptions in certain specific respects, which are discussed in the relevant sections below. AFR asserted that the Proposed Rule would allow branches of U.S. persons, which are actually formally and legally part of the parent U.S. organization, to effectively act as non-U.S. persons.[435] IATP stated that it only understands the Exchange-Traded Exception and did not

[434] Proposed Rule, 85 FR at 984.

[435] The Commission disagrees with this assertion. For example, under the Proposed Rule, group B requirements apply more broadly to foreign branches than to non-U.S. persons due to the limited scope of the Limited Foreign Branch Group B Exception as compared to the Non-U.S. Swap Entity Group B Exception (each discussed below), and foreign branches (as a part of a U.S. person) are not eligible for substituted compliance for the group A requirements.

comment on the other proposed exceptions. Its comment on the proposed Exchange-Traded Exception is discussed below.

2. Exchange-Traded Exception

(i) Proposed Rule

The Commission proposed 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)[436]) 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[437] 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.[438]

With respect to the group B trade confirmation requirement, the Commission noted 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

[436] 17 CFR 23.202(a) through (a)(1).

[437] The Commission stated that it would consider the proposed exception 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.

[438] *See* Proposed Rule, 85 FR at 982-983. This approach is similar to the Guidance. *See* Guidance, 78 FR at 45351-45352 and 45360-45361.

met.[439] 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,[440] 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 Commission noted that the portfolio reconciliation and compression and swap trading relationship documentation requirements would not apply to the 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.[441] For the last group B requirement – the daily trading records requirement[442] – the Commission stated that it 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 stated that the requirements of § 23.202(a) through (a)(1) should continue to apply, as 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 noted that, in particular, for certain

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[439] *See* 17 CFR 23.501(a)(4)(i) and 37.6(b).

[440] *See* 17 CFR 48.5(d)(2).

[441] *See* 17 CFR 23.502(d), 23.503(c), 23.504(a)(1)(iii).

[442] *See* 17 CFR 23.202.

pre-execution trade information under § 23.202(a)(1),[443] the swap entity may be the best, or only, source for such records, and for this reason, paragraphs (a) through (a)(1) of § 23.202 are carved out from the group B requirements in the proposed exception.

Additionally, the Commission noted that, given that this exception is predicated on anonymity, many of the group C requirements would be inapplicable.[444] Further, 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 supervision and regulation that is comparable to that to which Commission-registered SEFs are subject, the Commission also proposed 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. In the interest of international comity and because the proposed exception requires that the swap be exchange-traded and cleared, the Commission proposed that foreign-based swaps would also be excepted from the remaining group C requirements in these circumstances. The Commission noted that it 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.

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

[444] *See* 17 CFR 23.402(b) - (c), 23.430(e), 23.431(c), 23.450(h), 23.451(b)(2)(iii).

(ii) Summary of Comments

IIB/SIFMA requested that the Commission expand the exception to apply to all anonymous cleared swaps (whether or not the trading venue and clearing organization are registered or exempt from registration with the Commission), in light of the risk mitigating effects of central clearing and the regulatory compliance and market integrity protections of trading anonymously on a regulated platform. They stated that it is not necessary for the Commission to limit this exception for anonymous cleared swaps in a manner that would indirectly expand the SEF and DCO registration requirements to non-U.S. trading venues and clearing organizations with non-U.S. swap entity participants. Further, they asserted that if the counterparty to a swap was a U.S. person, the Commission's SEF and DCO registration requirements would independently require the trading venue and clearing organization to register with the Commission or obtain an exemption from registration. Additionally, IIB/SIFMA requested the exception be made available to U.S. swap entities, as well, except for daily trading records rules, arguing that the interposition of clearing organizations reduces risk to the United States, thereby obviating the need to apply the risk mitigation rules (where applicable). They also noted that SEFs provide market participants with the regulatory compliance protections associated with centralized trading and that many group C requirements already do not apply to a swap entity in connection with swaps executed anonymously, regardless of the U.S. person status of the swap entity.[445]

[445] In addition to noting the exceptions in the regulations themselves, IIB/SIFMA reference the relief provided by Staff Letter 13-70 for intended to be cleared swaps ("Staff ITBC Letter").

ISDA was supportive of the proposed exception, but requested that it be extended to cover: (1) all relevant group B and C requirements; and (2) U.S. and non-U.S. entities' transactions that are SEF- (or exempt SEF-) executed and cleared at a DCO, exempt DCO, or clearinghouse subject to CFTC no-action relief, regardless of whether they are anonymously executed. ISDA noted that one of the regulatory benefits of SEF trading is that market participants receive the necessary regulatory compliance protections associated with centralized trading, and that, as self-regulatory organizations, SEFs (and exempt SEFs) are expected to keep daily trading records and audit trails of each transaction executed on their platforms, so it makes sense to allow counterparties not to comply with group B requirements when executing trades on SEFs (or exempt SEFs), and restricting this exemption to a particular method of execution on a SEF does not serve any regulatory purpose. Moreover, ISDA argued that imposing CFTC external business conduct standards to centrally-executed and cleared trades also creates redundancies, as counterparties that trade on SEFs (or exempt SEFs) receive necessary disclosures as part of the onboarding process and regulatory required pre-trade credit checks ensure that counterparties have sufficient credit to execute transactions.

IATP stated that the biggest exception, in terms of the notional amount of swaps and the number of group B and C requirements that would be exempted from compliance, is the Exchange-Traded Exception, and that this exception would comport generally with G20 reform objectives to centrally clear swaps and trade them anonymously (preferably post-trade as well as pre-trade) on regulated exchanges. However, IATP objected to the granting of the exception for foreign SEFs and clearing organizations that have not qualified for registration with the Commission, but have been granted exemptions from registration, presumably in the interest of international comity, noting that if the Exchange-Traded Exception results in disapplication of Commission requirements to customized foreign affiliate swaps traded and cleared on exempted entities, the risks to U.S. ultimate parents could be most unexpected.

(iii) Final Rule

After carefully considering the comments, the Commission is adopting the exception as proposed.[446]

Regarding requests to expand the exception to include all anonymous foreign-based swaps entered into on an exchange and which are subsequently cleared, regardless of whether the exchange and clearing organization are registered or exempt from registration with the Commission, or to include swaps that are cleared on a DCO that has received staff no-action relief from registration requirements, the Commission is declining to expand the exception. As noted in the Proposed Rule, the exception is based, in part, on the swaps eligible for it being subject to independent requirements that apply to transactions on a DCM or registered SEF pursuant to Commission regulations or, with respect to exempt SEFs and registered FBOTs, to comprehensive supervision and regulation in their home countries. Similarly, the Commission believes that limiting the exception to DCOs that are registered or exempt provides assurance that the DCOs clearing swaps eligible for the exception will be subject to comprehensive supervision and regulation. Further, as explained above, the Commission does not find persuasive

[446] Final § 23.23(e)(1)(i). The Commission notes that the addition of the Subpart L requirements to the group C requirements under the Final Rule will not substantively expand the Exchange-Traded Exception as the Subpart L requirements do not apply to swaps cleared by a DCO. Also, as stated in the Proposed Rule, the Commission considers the exception 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.

IIB/SIFMA's argument that if the counterparty to a foreign-based swap is a U.S. person, other Commission rules require that the trade be executed on a registered or exempt SEF and cleared through a registered or exempt DCO.[447] The Commission will consider expanding the exception pending other amendments to the SEF/DCO regulations.

Regarding the request not to require that eligible foreign-based swaps be anonymous, the Commission declines to expand the exception in this manner. The other exceptions in the Final Rule provide relief where appropriate for foreign-based swaps where the counterparty is known, and this limited exception, as in the Guidance, is only meant to provide relief from certain of the group B and group C requirements where the counterparty is unknown and, thus, it would be impractical to comply with such requirements.

Regarding the request to allow U.S. swap entities (other than their foreign branches) to utilize the exception, the Commission declines to expand the exception in this manner. The Commission is of the view, consistent with the Guidance, that where a U.S. swap entity (other than its foreign branch) enters into a swap, that swap is part of the U.S. swap market. And, accordingly, the group B and group C requirements should generally apply fully to such swap entity.[448] In addition, the Commission is generally of the view that the Final Rule is not the appropriate place to make changes to the regulation of the U.S. swap market. Expanding the exception to cover swaps in the U.S. swaps market would require amendments to the underlying group B and group C requirements

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[447] *See supra* sections III.D and IV.D.

[448] The Commission notes that, as referenced by IIB/SIFMA and subject to certain specified conditions, the Staff ITBC Letter provides relief to all swap entities from certain of the group B and group C requirements for intended to be cleared swaps.

that apply to all covered swaps rather than creating a limited exception to them for certain foreign swaps. However, as comments were supportive of extending the exception to U.S. swap entities, the Commission will continue to analyze this issue and take these comments into consideration when next considering changes to the group B and group C requirements.

With respect to the request to include pre-execution trading records (*i.e.*, by revising the exception to apply to all group B requirements), the Commission declines to expand the exception in this manner. Excluding pre-execution trading records requirements is consistent with the Guidance and, as noted in the Proposed Rule, these requirements should continue to apply, as all swap entities should be required to maintain, among other things, sufficient records to conduct a comprehensive and accurate trade reconstruction for each swap, and the swap entity may be the best, or only, source for pre-execution trading records.

3. Foreign Swap Group C Exception

(i) Proposed Rule

The Commission proposed 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.[449] The Commission noted that 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.

[449] *See* Proposed Rule, 85 FR at 983-984. This approach is similar to the Guidance. *See* Guidance, 78 FR at 45360-45361. As used herein, the term swap includes transactions in swaps as well as swaps that are offered but not entered into, as applicable.

branch,[450] and, given that the group C requirements are intended to promote counterparty protections in the context of local market sales practices, foreign regulators may have a relatively stronger supervisory interest than the Commission in regulating such swaps in relation to the group C requirements. Accordingly, the Commission stated that it believed applying the group C requirements to these transactions may not be warranted.

The Commission noted 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 stated that it believes 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.

By contrast, the Commission stated that 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 conducted through a U.S. branch, the Commission believes it has a strong supervisory interest in regulating and enforcing the group C requirements, as 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

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[450] *See* discussion of the modification of the definition of a "swap conducted through a U.S. branch" to be a "swap booked in a U.S. branch" in section II.H.3, *supra*.

via swaps. Therefore, the Commission concluded that exercise of U.S. jurisdiction with respect to the group C requirements over such swaps is reasonable 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.[451]

(ii) Summary of Comments

ISDA stated that it fully agrees with the Commission that there is no policy benefit in subjecting non-U.S. market participants to the CFTC's extensive customer protection regime,[452] and therefore, believes that these rules should be left within the remit of home country regulators. Further, ISDA stated that it agrees that foreign branch ANE Transactions should not be subject to group C Requirements.[453] IIB/SIFMA also supported the proposed exception. However, ISDA and IIB/SIFMA requested specific changes to the underlying group C requirements, including that certain of the group C requirements apply only on an "opt-in" basis.

Specifically, ISDA stated that non-U.S. persons should be allowed to opt-in to receiving external business conduct disclosures from U.S. persons. Under ISDA's proposed alternative, unless a non-U.S. client chooses to "opt-in" into the full spectrum of the CFTC requirements, U.S swap entities and U.S. branches of non-U.S. swap entities would only have the obligation to provide disclosures related to: (1) prohibition on fraud, manipulation, and other abusive practices; (2) verification of ECP status; (3) material risks, excluding requirements to provide daily mark and scenario analysis; (4) fair dealing

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[451] *See supra* section I.D.2.

[452] As explained more fully below, the Commission notes that it did not make such a statement in the Proposed Rule.

[453] As explained more fully below, this statement does not wholly comport with the Commission's position as set forth in the Proposed Rule.

communications; and (5) brief descriptions of other external business conduct disclosures, including the option to opt-in to receiving such disclosures.

IIB/SIFMA similarly requested that, to better balance counterparty protection interests against the market fragmentation that results when swap entities ask their non-U.S. counterparties to enter into documentation designed to satisfy U.S. legal requirements, the Commission refine how the group C requirements apply to all swaps entered into by U.S. swap entities and U.S. branches of non-U.S. swap entities when they transact with non-U.S. counterparties, including swaps entered into by U.S. swap entities in the United States. IIB/SIFMA argued that, because the business conduct requirements are designed to provide customer protection rather than to mitigate risk to the United States, the Commission has a limited regulatory interest in mandating full application of its customer protection requirements to all swap transactions between swap entities and their non-U.S. counterparties. Further, IIB/SIFMA asserted that, in other contexts, the Commission has recognized that non-U.S persons do not generally implicate U.S. investor protection concerns (*e.g.*, in its CPO and CTA rules). They proposed that only the following requirements would apply to a U.S. swap entity (including its U.S. branches or when it otherwise trades in the United States) or U.S. branch of a non-U.S. swap entity when it trades with a non-U.S. counterparty unless otherwise opted into by a non-U.S. person counterparty: (1) the prohibition on fraud, manipulation, and other abusive practices (but not additional confidentiality requirements under § 23.410(c)); (2) verification of ECP status (although in their view such verification should not require a written representation regarding a specific prong of the ECP definition, as it does for U.S. persons); (3) disclosure of material risks (but not scenario analysis under § 23.431(b)), material characteristics and economic terms, and material conflicts of interest and incentives (but not pre-trade mid-market marks under § 23.431(a)(3)(i)), without requiring the counterparty to agree in writing to the manner of disclosure as under § 23.402(e) and (f); (4) fair and balanced communications; and (5) a one-time notification prior to entering into a new trading relationship with a non-U.S. counterparty that the non-U.S. counterparty may opt in to the additional customer protections provided by the remaining external business conduct rules along with a summary description of those rules. Further, IIB/SIFMA requested that the Commission clarify that non-U.S. persons are not "Special Entities" (as defined in CEA section 4s(h)(2)(C) and § 23.401(c)), considering that Congress was not seeking to protect foreign pension plans and endowments.

(iii) Final Rule – Foreign Swap Group C Exception and U.S. Branch Group C Exception

After carefully considering the comments, the Commission is adopting the exception as proposed.[454] The Commission recognizes that, although the exception is being adopted as proposed, the scope of the exception is being expanded because the Subpart L requirements have been added to the group C requirements under the Final Rule. For the reasons discussed in section VI.A.3, the Commission believes that the Subpart L requirements are appropriately classified as group C requirements and, thus, the expansion of the exception in this manner is appropriate.

In addition, based on the comments received, the Commission is adopting an additional exception from the group C requirements for certain swaps of U.S. branches of

[454] Final § 23.23(e)(1)(ii).

non-U.S. swap entities ("U.S. Branch Group C Exception"), as shown in the rule text in this release.[455] Specifically, under the U.S. Branch Group C Exception, a non-U.S. swap entity is excepted from the group C requirements with respect to any swap booked in a U.S. branch with a foreign counterparty that is neither a foreign branch nor a Guaranteed Entity. The Commission is adopting this exception because, although the swaps benefiting from the exception are part of the U.S. swap market, the Commission believes that foreign regulators have a stronger interest in such swaps with respect to the group C requirements — which relate to counterparty protection rather than risk mitigation — because they are between a non-U.S. swap entity (by definition, a non-U.S. person) and certain foreign counterparties that have a limited nexus to the United States (*i.e.*, non-U.S. persons, including SRSs that are not Guaranteed Entities). The Commission is not providing this exception to swaps booked in a U.S. branch of a non-U.S. swap entity with a foreign branch of a U.S. swap entity, Guaranteed Entity, or U.S. branch counterparty (where, for the U.S. branch, the swap is booked in the U.S. branch of the counterparty). A foreign branch (which is, by definition, a part of U.S. person), a Guaranteed Entity, and a U.S. branch counterparty have a closer nexus to the United States, and, thus, the Commission believes that the group C requirements should continue to apply to swaps with such counterparties.

Regarding the requests to change the application of some or all of the group C requirements to swaps entered into by U.S. swap entities and U.S. branches of non-U.S. swap entities when they transact with non-U.S. counterparties such that certain of the requirements would apply only where non-US counterparties "opt-in" to such treatment,

[455] Final § 23.23(e)(2).

the Commission is of the view that where a U.S. swap entity (other than its foreign branch) enters into a swap or where a swap is booked in a U.S. branch of a non-U.S. swap entity, those swaps are part of the U.S. swap market, and, accordingly, other than as provided in the U.S. Branch Group C Exception, the group C requirements should generally apply fully to such swap entities, regardless of the U.S. person status of its counterparty.

In response to IIB/SIFMA's comment that adopting their requested change is in line with the Commission's recognition in the CPO/CTA context that non-U.S persons do not generally implicate U.S. investor protection concerns, the Commission has never stated that U.S.-based CPOs/CTAs do not need to register or comply with the Commission's applicable rules. Rather, under § 3.10(c)(3), a foreign person is not required to register as a CPO/CTA (or comply with most Commission regulations) in connection with commodity interest transactions on behalf of persons located outside the United States that are submitted for clearing through a registered futures commission merchant. Moreover, a CPO/CTA advising a customer on the investment of their funds or managing such investment is in a fundamentally different position than a swap entity that is acting as a counterparty under a swap. In addition, as noted above, the Commission is of the view that, generally, the Final Rule is not the appropriate place to make changes to the regulation of the U.S. swap market. Making the group C requirements an "opt-in" regime would require changing the underlying group C requirements that apply to all covered swaps rather than creating a limited exception to them for certain foreign swaps.

On the request of IIB/SIFMA that the Commission "clarify" that non-U.S. persons are not Special Entities because "Congress was not seeking to protect foreign pension plans and endowments," the Commission received similar comments when it adopted the definition of "Special Entity" in its final rule on external business conduct standards for swap entities and addressed them in that rulemaking.[456] First, the Commission, in interpreting the CEA, refined the definition of "Special Entity" to remove, among other things, certain foreign employee benefit plans from the scope of the definition.[457] Second, the Commission expressly addressed foreign endowments potentially being classified as Special Entities, saying that because "the statute does not distinguish between foreign and domestic counterparties in Section 4s(h) . . . the Commission has determined that prong (v) of Section 4s(h)(2)(C) and § 23.401(c)(5) [the endowment prongs of the definitions] will apply to any endowment, whether foreign or domestic."[458] Therefore, the Commission is declining to provide the clarification that IIB/SIFMA requested.

Regarding ISDA's statement that it fully agrees with the Commission that there is no policy benefit in subjecting non-U.S. market participants to the CFTC's extensive customer protection regime and, therefore, believes that these rules should be left within the remit of home country regulators, this statement does not wholly comport with the Commission's position as set forth in the Proposed Rule. Rather, the Commission proposed that only certain foreign-based swaps meeting the eligibility criteria for the

[456] Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 77 FR 9733, 9774-75 (Feb. 2012).

[457] *Id*. at 9776.

[458] *Id*.

exception would be excepted from the group C requirements. ISDA also stated that it agrees that foreign branch ANE Transactions should not be subject to group C Requirements. The Commission notes that this would only be true to the extent the swap is conducted through the relevant foreign branch or branches, which would require, among other things, that the swap be entered into by each relevant foreign branch in its normal course of business. 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. Under the Final Rule (and as proposed), where the swap is primarily entered into by personnel not located in a foreign branch of the U.S. bank, this requirement would not be satisfied.

4. Limited Foreign Branch Group B Exception

(i) Proposed Rule

The Commission proposed 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 limitations.[459] Specifically, under the Proposed Rule: (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.

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[459] *See* Proposed Rule, 85 FR at 984. 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.

As discussed in the Proposed Rule, the Commission proposed the Limited 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.[460] The Commission stated that it believes the Limited 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 noted that it 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 stated that it preliminarily believed that the swap activity that would be excepted from the group B requirements would not raise significant supervisory concerns.

(ii) Summary of Comments

IIB/SIFMA generally supported this exception, but requested that the Commission clarify that: (1) the exception applies on a swap-by-swap, requirement-by-requirement basis; (2) that it is optional for a U.S. swap entity to rely on the exception for any given swap; and (3) that the five percent notional amount cap would only cover transactions entered into "in reliance on" the exception, not all swaps eligible for the exception. In a subsequent discussion with Commission staff, IIB/SIFMA further

[460] As noted above, under the Proposed Rule, where substituted compliance is available for a particular group B requirement and swap, the exception would not be available.

clarified their request that the exception should apply on a "requirement-by-requirement basis" to mean that the exception should have a separate five percent gross notional amount cap applicable to each requirement, rather than a single five percent gross notional amount cap where any swap that relied on the exception for any group B requirement would count towards the cap. State Street also supported the proposed exception; however, it requested that the Commission provide further guidance on the calculation of the notional amount cap.

IIB/SIFMA also asked that, consistent with its other requests, the exception be available when a foreign branch transacts with an SRS that is not a swap entity or with a U.S. branch of a foreign bank. With respect to such an entity, IIB/SIFMA noted that the group B requirements indirectly regulate the end user (*i.e.*, non-swap entity) counterparties of swap entities by requiring them to execute documentation and engage in portfolio reconciliation and compression exercises, when they trade with swap entities subject to the requirements. IIB/SIFMA asserted that many more end users will qualify as SRSs than swap entities under the proposed definition because, unlike swap entities, commercial and non-financial end users generally will not qualify for the exclusions from the SRS definition and that, as a result, significant foreign subsidiaries of large U.S. multinational companies would find themselves subject to group B requirements when they trade with non-U.S. swap entities. IIB/SIFMA noted that the indirect application of the group B requirements would pose particular problems for significant subsidiaries doing business in emerging market jurisdictions that have not yet adopted comparable rules to the group B requirements because swap entities' operations in those jurisdictions might not be set up to apply the group B requirements to trading with those subsidiaries, and that this could cause those subsidiaries to lose access to key interest or currency hedging products and face increased hedging and risk management costs relative to their foreign competitors. IIB/SIFMA also stated that subjecting an SRS that is not a swap entity to group B requirements would impose undue costs on non-U.S. swap entities, noting that because the SRS test depends on a non-U.S. counterparty's internal organizational structure and financial metrics, it generally would not be possible for a swap entity to determine whether its non-U.S. counterparty is an SRS without obtaining an affirmative representation and, because it would be difficult for a swap entity categorically to rule out any class of non-U.S. counterparties from being an SRS, swap entities would be forced to obtain relevant representations from nearly their entire global client bases.

Further, IIB/SIFMA noted that any credit or legal risks arising from swaps conducted in reliance on the exception should already be addressed through existing provisions of § 23.600 and, accordingly, they assume the Proposed Rule was not meant to imply some additional risk management program requirement in connection with reliance on the exception.

JBA asked that the Commission review the Proposed Rule from the perspective of ensuring symmetric application of requirements between U.S. swap entities and non-U.S. swap entities. Specifically, JBA requested that an exception consistent with the Limited Foreign Branch Group B Exception should be applicable to the non-U.S. swap entities even when their counterparty is a foreign branch of a U.S. person. As an example, JBA stated that when the Seoul branch of a U.S. bank that is registered as an SD enters into a swap with the Tokyo headquarters of a Japanese bank that is registered as an SD, the U.S.

bank SD may rely on the Limited Foreign Branch Group B Exception, whereas the Japanese bank SD may not rely on an exception from the group B requirements.

ISDA stated that it agrees that foreign branch ANE Transactions should not be subject to group B requirements where substituted compliance is available.[461]

(iii) Final Rule

After carefully considering the comments, the Commission is adopting the exception with certain modifications, as shown in the rule text in this release.[462] Specifically, the Commission is: (1) adjusting the exception such that it is not available for swaps between swap entities; (2) broadening the exception to apply to foreign-based swaps with an SRS End User; and (3) making some minor technical changes to the text of the Final Rule.

The Commission believes that a swap between the foreign branch of a U.S. swap entity and a non-U.S. swap entity should generally be subject to the group B requirements. Where both parties to a swap are swap entities, the rationale for the Limited Foreign Branch Group B Exception is not present. As discussed in the Proposed Rule and the Guidance, as well as above, the exception is designed 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 (a) 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, and (b) to preserve liquidity in the emerging markets in which it expects

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[461] As discussed more fully below, this statement is not an accurate description of the Proposed Rule.

[462] Final § 23.23(e)(4).

this exception to be utilized. Where both parties to a swap are registered swap entities, the Commission sees no impediment to compliance with the group B requirements.

With respect to SRS End Users, the Commission acknowledges that applying the group B requirements to a swap entity's swaps indirectly affects their counterparties, including SRS End User counterparties, by requiring them to execute documentation (*e.g.*, compliant swap trading relationship documentation), and engage in portfolio reconciliation and compression exercises as a condition to entering into swaps with swap entity counterparties. As noted by IIB/SIFMA, requiring compliance with these obligations may cause counterparties, including SRS End Users, to face increased costs relative to their competitors not affected by the application of the group B requirements (*e.g.*, for legal fees or as a result of costs being passed on to them by their swap entity counterparties), and/or to potentially lose access to key interest or currency hedging products. Also, the Commission recognizes that, as IIB/SIFMA notes, because the SRS test depends on a non-U.S. counterparty's internal organizational structure and financial metrics and it would be difficult to rule out any category of non-U.S. counterparties as being an SRS, the proposed application of group B requirements to all SRSs may cause swap entities to obtain SRS representations from nearly their entire non-U.S. client bases, potentially increasing costs for all of these clients.

Taking this into account and the Commission's belief that it is important to ensure that an SRS, particularly a commercial or non-financial entity, continues to have access to swap liquidity for hedging or other non-dealing purposes, the Commission is expanding the exception only to SRS End Users (and not to SRSs that are swap entities ("SRS Swap Entities") or Guaranteed Entities). The Commission believes that an SRS

End User does not pose as significant a risk to the United States as an SRS Swap Entity or a Guaranteed Entity, because an SRS End User: (1) has a less direct connection to the United States than a Guaranteed Entity; and (2) has been involved, at most, in only a de minimis amount of swap dealing activity, or has swap positions below the MSP thresholds, such that it is not required to register as an SD or MSP, respectively. In addition, because the SRS category was first considered in the Proposed Rule, unlike for Guaranteed Entities, there is no precedent in the Guidance to apply the group B requirements to all SRSs as originally proposed. Moreover, treating SRSs End Users and Guaranteed Entities differently under the exception is consistent with the differences in swap counting requirements under the Final Rule.[463] For example, an Other Non-U.S. Person is generally not required to count a dealing swap with an SRS toward its de minimis threshold calculation for SD registration, whereas an Other Non-U.S. Person is (absent certain exceptions) generally required to count its dealing swaps with a Guaranteed Entity.

In addition, in response to commenters requesting further guidance on the application of the exception, the Commission is clarifying that the five percent gross notional amount cap applies only to swaps entered into in reliance on the exception. This does not include situations where a foreign branch of a U.S. swap entity complies with all of the group B requirements, either directly or through substituted compliance, with respect to a swap that is eligible for the exception. In such situation, though the swap is eligible for the exception for the requirements not addressed by substituted compliance, it does not count toward the five percent gross notional amount cap for swaps entered into

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[463] *See* discussion of counting requirements of swaps with SRSs in sections III.B.1 and IV.B.1, *supra*.

in reliance on the exception because compliance with the applicable group B requirements was achieved. On the other hand, where a foreign branch relies on the exception with respect to any group B requirement for a swap, the notional amount of that swap counts toward the five percent gross notional amount cap for the relevant calendar quarter. The Commission is declining to expand the five percent cap as requested by IIB/SIFMA such that there would be a separate five percent gross notional amount cap for each group B requirement, because it believes such an exception would potentially allow a much greater percentage of swaps by notional amount to be eligible for the exception, and it would be difficult for a swap entity to track and for the Commission and the National Futures Association ("NFA") to monitor compliance with such a standard. Accordingly, the five percent cap applies on a swap-by-swap basis, but does not apply on a requirement-by-requirement basis such that a foreign branch may rely on the exception for greater than five percent of its swaps by gross notional amount in any calendar quarter.

Regarding the request to expand the exception to make it available to swaps of a foreign branch with U.S. branches of foreign banks, the Commission does not believe that such an expansion is appropriate. As noted above, the exception is designed 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. It is not designed to allow foreign branches to transact with U.S. branches of non-U.S. banking organizations without complying with the group B requirements. A foreign branch of a U.S. bank is a U.S. person, and, as noted above, the Commission is of the view that where a swap is booked in a U.S. branch, that swap is part of the U.S. swap market.

Accordingly, the Commission retains a supervisory interest in swaps between a foreign branch and a U.S. branch such that the group B requirements should generally apply to such swaps.

Regarding ISDA's statement that it agrees that foreign branch ANE Transactions should not be subject to group B requirements where substituted compliance is available, the Commission notes that this statement is not accurate as the Limited Foreign Branch Group B Exception does not apply where substituted compliance is available. Also, as discussed above, even where substituted compliance is not available, this statement would only be true to the extent the swap is conducted through the relevant foreign branch or branches, which would require, among other things, that the swap be entered into by each relevant foreign branch in its normal course of business. 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. Under the Final Rule (and as proposed), where the swap is primarily entered into by personnel not located in a foreign branch of the U.S. bank, this requirement would not be satisfied.

Further, in line with IIB/SIFMA's comment, the Commission confirms that its stated expectation that swap entities will 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 is not meant to imply an additional risk management program requirement, but rather to remind swap entities of their obligations under § 23.600.

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

(i) Proposed Rule

The Commission also proposed 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.[464] The Commission stated that, in these circumstances, where no party to the foreign-based swap is a U.S. person, a Guaranteed Entity, or an SRS, and, the particular swap is not conducted through a U.S. branch[465] of a party, 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.

The Commission noted that, generally, it would expect that swap entities that rely on this exception are 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.[466]

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[464] *See* Proposed Rule, 85 FR at 984. This approach is similar to the Guidance; however, the Commission notes that the Proposed Rule limited 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 45352-45353.

[465] *See* discussion of the modification of the definition of a "swap conducted through a U.S. branch" to be a "swap booked in a U.S. branch" in section II.H.3, *supra*.

[466] *See* 2019 FSB Progress Report, Table M.

(ii) Summary of Comments

IIB/SIFMA agreed with the Commission that foreign regulators have a stronger supervisory interest in these swaps than the Commission in regards to the risk mitigation matters covered by the group B requirements, but recommended that the Commission expand the proposed exception by: (1) applying the exception to swaps with an SRS that is not a swap entity, so as to avoid inappropriately burdening the foreign subsidiaries of U.S. multinational corporations and their counterparties (as discussed in section VI.B.4 above); (2) conforming the treatment of a non-U.S. swap entity that either is an SRS Swap Entity or benefits from a U.S. guarantee for the relevant swap ("Guaranteed Swap Entity") to the Guidance[467] (or, at a minimum, adopting an exception for de minimis trading by these entities in jurisdictions not eligible for substituted compliance similar to the Limited Foreign Branch Group B Exception where, for SRS Swap Entities, the five percent notional amount cap would apply at the level of the ultimate U.S. parent entity), so as to minimize the competitive disadvantages faced by such swap entities and their counterparties when they are subject to U.S. rules extraterritorially; and (3) permitting a U.S. branch to rely on the exception when it trades with a non-U.S. person that is neither a Guaranteed Entity nor another U.S. branch, which, in their view, would appropriately recognize that such swaps do not present risks to the United States, are generally unnecessary due to home country regulation, and align the scope of the exception to be consistent with analogous EU rules.

[467] The Commission notes that SRSs were not contemplated by the Guidance, so the Commission assumes that the comment requested that the Commission conform the treatment of SRSs to conduit affiliates under the Guidance.

JFMC/IBAJ similarly requested that the Commission exclude transactions between a Guaranteed Swap Entity or an SRS Swap Entity and an Other Non-U.S. Person from the application of group B requirements, stating that these requirements would not apply to such transactions under the Guidance and they see no justification for the change in Commission policy. They argued that the expanded extraterritorial application will indirectly impose regulatory compliance burdens on Japanese market participants, most of which are Other Non-U.S. Persons, when trading swaps with Guaranteed Swap Entities, especially where a Guaranteed Swap Entity cannot rely on substituted compliance with local Japanese regulations to satisfy group B requirements, and that Japanese market participants will likely refrain from trading swaps with a Guaranteed Swap Entity to avoid the indirect imposition of the Commission's swaps regulations and the costs associated therewith. They noted that this may diminish the ability of U.S.-headquartered firms to compete or access liquidity in the Japanese swaps market, which could result in fragmented global swaps markets comprised of small and disconnected liquidity pools, leading to exacerbation of systemic risk.

ISDA requested that, in line with the Proposed Rule's intent to give deference to home country regulators where there are applicable foreign regulatory requirements, the Commission not apply the proposed group B requirements to transactions between: (1) U.S. branches of non-U.S. swap entities and Other Non-U.S. Persons; and (2) Guaranteed Entities and Other Non-U.S. Persons, supporting the position and rationale of IIB/SIFMA on this topic. ISDA noted that the Commission has set a precedent for taking this approach by providing an exemption in the Guidance to Guaranteed Entities from compliance with group B requirements when transacting with Other Non-U.S. Persons.[468]

(iii) Final Rule – Non-U.S. Swap Entity Group B Exception and Limited Swap Entity SRS/Guaranteed Entity Group B Exception

After carefully considering the comments, the Commission is adopting the Non-U.S. Swap Entity Group B Exception with certain modifications, as shown in the rule text in this release.[469] Specifically, for the same reasons that the Commission is expanding the Limited Foreign Branch Group B Exception to include swaps with SRS End Users,[470] the Commission is also expanding the Non-U.S. Swap Entity Group B Exception to include swaps with SRS End Users.

In addition, based on the comments received, the Commission is adopting an additional limited exception from the group B requirements similar to the Limited Foreign Branch Group B Exception in the Final Rule (discussed above), for trading by an SRS Swap Entity or a Guaranteed Swap Entity, on the one hand, and certain non-U.S. persons, on the other ("Limited Swap Entity SRS/Guaranteed Entity Group B Exception"), as shown in the rule text in this release.[471] As commenters noted, under the Guidance, a Guaranteed Swap Entity or a non-U.S. swap entity that was a conduit affiliate would not have been expected to comply with the group B requirements when

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[468] The Commission assumes that ISDA was referring to non-U.S. Persons that are not a guaranteed or conduit affiliate of a U.S. Person (each as defined or described in the Guidance), as the term "Other Non-U.S. Person" is not used in the Guidance.

[469] Final § 23.23(e)(3).

[470] *See supra* section VI.B.4.iii.

[471] Final § 23.23(e)(5). As noted above, the Commission, generally, expects that swap entities that rely on this exception are 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.

transacting with a non-U.S. person that was not a conduit or guaranteed affiliate, so the Proposed Rule deviated from the Guidance and would have disadvantaged SRS Swap Entities and Guaranteed Swap Entities relative to foreign branches of U.S. swap entities in the application of the group B requirements. Thus, the Commission believes a limited exception is warranted because, as a policy matter, it has determined that Guaranteed Swap Entities and SRS Swap Entities (who, by definition, are non-U.S. persons) should not be subject to stricter application of the group B requirements than foreign branches of U.S swap entities (who are U.S. persons). Under the Limited Swap Entity SRS/Guaranteed Entity Group B Exception, each Guaranteed Swap Entity and SRS Swap Entity is excepted from the group B requirements, with respect to any foreign-based swap with a foreign counterparty (other than a foreign branch) that is neither a swap entity[472] nor a Guaranteed Entity, subject to certain conditions. Specifically, (1) the exception is not available with respect to any group B requirement if the requirement as applicable to the swap is eligible for substituted compliance pursuant to a comparability determination issued by the Commission prior to the execution of the swap (discussed in sections VI.C and VI.D below); and (2) in any calendar quarter, the aggregate gross notional amount of swaps conducted by an SRS Swap Entity or a Guaranteed Swap Entity in reliance on this exception aggregated with the gross notional amount of swaps conducted by all affiliated SRS Swap Entities and Guaranteed Swap Entities in reliance on this exception does not

[472] As discussed above, the Commission is also excluding swaps with a swap entity counterparty from the Limited Foreign Branch Group B Exception.

exceed five percent of the aggregate gross notional amount of all swaps entered into by the SRS Swap Entity or a Guaranteed Swap Entity and all affiliated swap entities.[473]

With respect to the request to dis-apply fully the group B requirements to swaps between an SRS Swap Entity or Guaranteed Swap Entity, on the one hand, and an Other Non-U.S. Person on the other, the Commission believes that the group B requirements should generally continue to apply to these swaps, as these requirements relate to risk mitigation, and SRS Swap Entities and Guaranteed Swap Entities may pose significant risk to the United States. Other than the Limited Foreign Branch Group B Exception, this matches the treatment of swaps between a foreign branch of a U.S. swap entity and an Other Non-U.S. Person under the Proposed Rule. Therefore, it is the Commission's view that providing the Limited Swap Entity SRS/Guaranteed Entity Group B Exception (discussed above) to put these entities on a substantially similar footing as such foreign branches under the group B requirements under the Final Rule is the better approach.

Regarding the requests to expand the exception to include transactions between U.S. branches and certain non-U.S. persons, the Commission declines such an expansion. As noted above, the Commission believes that where a swap is booked in a U.S. branch of a non-U.S. swap entity, that swap is part of the U.S. swap market, and, accordingly, the group B requirements should generally apply.

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[473] Final § 23.23(e)(5)(i) and (ii). As described above for the Limited Foreign Branch Group B Exception, a swap entered into by a SRS Swap Entity or Guaranteed Swap Entity will only count toward the gross notional amount cap where it is entered into in reliance on the Limited Swap Entity SRS/Guaranteed Entity Group B Exception.

C. Substituted Compliance

As discussed in the Proposed Rule, substituted compliance is a fundamental component of the Commission's cross-border framework.[474] 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 adopt consistent and comparable regulatory regimes that can result in deference to each other's regime. 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.[475] When properly calibrated, substituted compliance promotes open, transparent, and competitive markets without compromising market integrity. On the other hand, if construed too broadly, substituted compliance could defer important regulatory interests to foreign regulators that have not implemented comparably robust regulatory frameworks.

The Commission has determined that, in order to achieve the important policy goals of the Dodd-Frank Act, U.S. swap entities (excluding their foreign branches) must be fully subject to the Dodd-Frank Act requirements addressed by the Final Rule, without regard to whether their counterparty is a U.S. or non-U.S. person. Given that such firms are U.S. persons conducting their business within the United States, their activities

[474] 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).

[475] *See* Dodd-Frank Act, section 752(a); 15 U.S.C. 8325.

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' and foreign branches' swaps with non-U.S. persons have a more attenuated nexus to U.S. commerce. Further, the Commission acknowledges that foreign jurisdictions also have a supervisory interest in such swaps. The Commission therefore believes that substituted compliance is 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 principles of international comity, the Commission is implementing a substituted compliance regime with respect to the group A and group B requirements that builds upon the Commission's prior substituted compliance framework and aims to promote diverse markets without compromising the central tenets of the Dodd-Frank Act. As discussed below, the Final Rule outlines the circumstances in which a non-U.S. swap entity or foreign branch of a U.S. swap entity is permitted to comply with the group A and/or group B requirements by complying with comparable standards in its home jurisdiction.

1. Proposed Rule

The Commission proposed to permit a non-U.S. swap entity to avail itself of substituted compliance with respect to the group A requirements on an entity-wide basis.[476] The Commission also proposed to permit a non-U.S. swap entity or a foreign branch of a U.S. swap entity to avail itself of substituted compliance with respect to the

[476] *See* Proposed § 23.23(f)(1); Proposed Rule, 85 FR at 985.

group B requirements for its foreign-based swaps with foreign counterparties.[477] The Commission did not propose to permit substituted compliance for the group C requirements, where broader exceptions for swaps with foreign counterparties would be available.

2. Summary of Comments

Chatham, JFMC/IBAJ, and BGC/Tradition generally supported the Proposed Rule's approach to substituted compliance, stating that it is consistent with the principles of international comity. The Commission also received two comments requesting that the Commission expand the proposed scope of substituted compliance. Specifically, AIMA stated that the Commission should expand the availability of substituted compliance by making it available to cross-border transactions as far as possible, including any swap involving a non-U.S. person, even swaps with U.S. persons. AIMA stated that the Commission's supervisory interest in the swap activities of U.S. persons should not prelude the availability of substituted compliance for U.S. persons. AIMA also supported a universal, entity-wide approach to substituted compliance, whereby substituted compliance would be fully available for cross-border transactions.

In addition, IIB/SIFMA stated that the Commission should expand the availability of substituted compliance for the group B requirements to: (1) all swaps entered into by a non-U.S. swap entity or foreign branch, including swaps with U.S. persons; and (2) swaps conducted through a U.S. branch.[478] IIB/SIFMA further requested that the Commission make substituted compliance available for the group C requirements where

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[477] *See* Proposed § 23.23(f)(2); Proposed Rule, 85 FR at 985.

[478] *See* discussion of the modification of the definition of a "swap conducted through a U.S. branch" to be a "swap booked in a U.S. branch" in section II.H.3, *supra*.

such requirements apply. IIB/SIFMA noted that the SEC permits substituted compliance for U.S.-facing transactions with respect to its external business conduct standards.

3. Final Rule

After carefully considering the comments, the Commission is adopting the scope of substituted compliance largely as proposed. The Commission continues to believe that the group A requirements, which relate to compliance programs, risk management, and swap data recordkeeping, cannot be effectively applied on a fragmented jurisdictional basis. Accordingly, it is not practical to limit substituted compliance for the group A requirements to only those transactions involving non-U.S. persons. Therefore, in furtherance of international comity, the Final Rule permits a non-U.S. swap entity, subject to the terms of the relevant comparability determination, to satisfy any applicable group A requirement on an entity-wide basis by complying with the applicable standards of a foreign jurisdiction.[479]

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. As noted above, the Commission believes that Congress intended for the Dodd-Frank Act to apply fully to U.S. persons (other than their foreign branches) with no substituted compliance available; therefore, an expansion of substituted compliance for the group B requirements for U.S. persons is not appropriate. However, in light of the comments received, the Commission has reconsidered the availability of substituted compliance for

[479] Final § 23.23(f)(1).

U.S. branches of non-U.S. swap entities. In the Proposed Rule, the Commission treated a swap conducted through a U.S. branch[480] in the same manner as a swap of a U.S. swap entity for the purposes of substituted compliance. The Commission acknowledges, however, that a swap booked in a U.S. branch of a non-U.S. swap entity with a foreign counterparty that is neither a foreign branch nor a Guaranteed Entity has a comparatively smaller nexus to U.S. commerce than a swap booked in a U.S. branch with a U.S. person, Guaranteed Entity, or another U.S. branch.

Accordingly, subject to the terms of the relevant comparability determination, the Final Rule permits 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. Specifically, given the Commission's interest in promoting international comity and market liquidity, the Final Rule allows a non-U.S. swap entity or foreign branch of a U.S. swap entity, subject to the terms of the relevant comparability determination, to satisfy any applicable group B requirement for a foreign-based swap with a foreign counterparty by complying with the applicable standards of a foreign jurisdiction.[481] Further, the Final Rule allows a non-U.S. swap entity, subject to the terms of the relevant comparability determination, to satisfy any applicable group B requirement for any swap booked in a U.S. branch with a foreign

[480] *See* discussion of the modification of the definition of a "swap conducted through a U.S. branch" to be a "swap booked in a U.S. branch" in section II.H.3, *supra*.

[481] Final § 23.23(f)(2). Thus, substituted compliance is not available for a swap booked in the U.S. branch of a non-U.S. swap entity entered into with a foreign branch of a U.S. swap entity.

counterparty that is neither a foreign branch nor a Guaranteed Entity by complying with the applicable standards of a foreign jurisdiction.[482]

The Commission is also modifying the text of § 23.23(f)(1) and (2) as shown in the rule text in this release (and including rule text in § 23.23(f)(3)) to clarify that substituted compliance is only available to a non-U.S swap entity or foreign branch of a U.S. swap entity to the extent permitted by, and subject to any conditions specified in, a comparability determination, and only where it complies with the standards of a foreign jurisdiction applicable to it, as opposed to other foreign standards to which it is not subject.[483]

With respect to the group C requirements, the Commission reiterates its longstanding position that it has a strong supervisory interest in ensuring that the counterparty protections of the group C requirements generally apply to swaps with U.S. persons with no substituted compliance available.

D. Comparability Determinations

The Commission is also implementing a process pursuant to which it will, in connection with certain requirements addressed by the Final Rule, conduct comparability determinations regarding a foreign jurisdiction's regulation of swap entities. This approach builds upon the Commission's prior 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

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[482] Final § 23.23(f)(3).

[483] Final § 23.23(f)(1) through (3).

Final Rule outlines procedures for initiating comparability determinations, including eligibility and submission requirements, with respect to certain requirements addressed by the Final Rule. The Final Rule also establishes a standard of review that the Commission will apply to such comparability determinations that emphasizes a holistic, outcomes-based approach. The Final Rule does not affect the effectiveness of any existing Commission comparability determinations that were issued consistent with the Guidance, which will remain effective pursuant to their terms.[484] The Commission may, however, reevaluate prior comparability determinations in due course pursuant to the terms of the Final Rule.

As discussed above, the Final Rule permits 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, will remain subject to the Commission's examination and enforcement authority.[485] Accordingly, if a swap entity fails to comply with a foreign jurisdiction's relevant standards, or the terms of the applicable comparability determination, the

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[484] *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); Comparability Determination for Japan: Certain Transaction-Level Requirements, 78 FR 78890 (Dec. 27, 2013).

[485] Final § 23.23(g)(5). The Commission notes that 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.

Commission may initiate an action for a violation of the Commission's corresponding requirements.

1. Standard of Review

(i) Proposed Rule

The Commission proposed a flexible outcomes-based approach that emphasized comparable regulatory outcomes over identical regulatory approaches. Specifically, the Commission proposed a standard of review that was designed to allow the Commission to consider all relevant elements of a foreign jurisdiction's regulatory regime, thereby permitting the Commission to tailor its assessment to a broad range of foreign regulatory approaches.[486] Accordingly, pursuant to the Proposed Rule, a foreign jurisdiction's regulatory regime did not need to be identical to the relevant Commission requirements, so long as both regulatory frameworks are comparable in terms of holistic outcome. The Proposed Rule permitted the Commission to consider any factor it deems appropriate when assessing comparability.[487]

(ii) Summary of Comments

The Commission received five comments that generally supported the proposed standard of review. However, of those commenters, JFMC/IBAJ and ISDA stated that the Commission should not consider whether a foreign jurisdiction has issued a reciprocal comparability determination in its assessment.

Further, the Commission received four comments opposing the proposed standard of review. Specifically, AFR, Better Markets, Citadel, and IATP stated that the proposed

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[486] *See* Proposed § 23.23(g)(4); Proposed Rule, 85 FR at 986-987.

[487] *Id*.

standard provides the Commission with overly-broad discretion that undermines objectivity in the assessment process. Citadel contended that the proposed standard may harm U.S. investors as a result of an overall reduction in market transparency and liquidity if trading activity is permitted to migrate to less transparent jurisdictions as a result of inaccurate comparability determinations.

IATP stated that the Commission should not base comparability on a foreign jurisdiction's supervisory guidelines or voluntary standards. IATP stated that if a foreign jurisdiction lacks a standard that compares to a Commission requirement, the Commission should issue a more limited comparability determination until such time as the foreign jurisdiction has published a standard that would result in a regulatory outcome comparable to the Commission's requirements. IATP also stated that regulatory deference to jurisdictions whose rules the Commission finds to produce regulatory outcomes comparable to those of the Commission must not be vague, unconditional, nor of indefinite duration. IATP noted that during market events or credit events, or in the event of swaps trading data anomalies, the Commission must retain the means to verify that the foreign affiliate swaps trading of U.S. parents does not result in losses that the U.S. parent must guarantee, either as a matter of law or a matter of market practice.

Citadel also recommended that the Commission provide an opportunity for public comment prior to finalizing a comparability determination to ensure that all relevant costs and benefits are considered.

(iii) Final Rule

After carefully considering the comments, the Commission is adopting the standard of review as proposed, with certain modifications as shown in the rule text in this release.[488] Specifically, the Commission is making some technical changes to the standard of review to clarify, as stated in the Proposed Rule[489] and discussed below, that the Commission may issue a comparability determination based on its determination that some or all of the relevant foreign jurisdiction's standards would result in outcomes comparable to those of the Commission's corresponding requirements or group of requirements.[490]

The Commission believes that this standard of review appropriately reflects a flexible, outcomes-based approach that emphasizes comparable regulatory outcomes over identical regulatory approaches. Accordingly, pursuant to the Final Rule, the Commission may consider any factor it deems appropriate in assessing comparability, 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.[491] In assessing comparability, the Commission need not find that a foreign jurisdiction has a comparable regulatory standard that corresponds to each group A or group B requirement. Rather, the

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[488] § 23.23(g)(4)

[489] See Proposed Rule, 85 FR at 986.

[490] *Id*.

[491] Final § 23.23(g)(4).

Commission may find a foreign jurisdiction's standards comparable if, viewed holistically, the foreign jurisdiction's standards achieve a regulatory outcome that adequately serves the same regulatory purpose as the group A or group B requirements as a whole.

Further, given that some foreign jurisdictions may implement prudential supervisory guidelines in the regulation of swaps, the Final Rule allows the Commission to base comparability on a foreign jurisdiction's regulatory standards, rather than regulatory requirements. The Guidance similarly provided that the Commission has broad discretion to consider "all relevant factors" in assessing comparability, in addition to a non-exhaustive list of elements of comparability.[492] However, this standard of review is broader than the Guidance in that it explicitly allows the Commission to consider a foreign jurisdiction's regulatory standards (as opposed to regulatory requirements) comparable to the CEA and Commission regulations, as experience has demonstrated that such standards are often implemented in a similar manner as the Commission's swaps regime.

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, 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

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[492] Guidance, 78 FR at 45353.

Commission may impose any terms and conditions on a comparability determination that it deems appropriate.[493]

The Final Rule adopts many of the Commission's existing practices with respect to comparability determinations, and does not reflect a significant change in policy. Accordingly, the phrasing of the standard of review is primarily intended to clarify, rather than change, the standard of review articulated in the Guidance. Reciprocity is only one of many non-determinative factors that the Commission may consider when assessing comparability. However, absence of a reciprocal comparability determination would not preclude a finding of comparability on the part of the Commission. Further, the Commission may, at its own discretion, seek public comment on any comparability determination issued pursuant to the Final Rule.

2. Supervision of Swap Entities Relying on Substituted Compliance

The Commission proposed to retain its examination and enforcement authority with respect to all swap entities relying on substituted compliance.[494] Accordingly, if a swap entity failed to comply with a foreign jurisdiction's relevant standards, or the terms of an applicable comparability determination, the Commission could initiate an action for a violation of the Commission's corresponding requirements.

IIB/SIFMA requested that the Commission state that it and NFA would not independently examine for or otherwise assess whether a swap entity is complying with foreign standards, but would instead look to the relevant foreign regulatory authority to

[493] Final § 23.23(g)(6).

[494] *See* Proposed § 23.23(g)(5); Proposed Rule, 85 FR at 986. The Commission notes that it similarly retained its examination and enforcement authority in comparability determinations that were issued pursuant to the Guidance.

conduct such examinations or assessments. IIB/SIFMA contended that the Commission and NFA lack the subject-matter expertise to interpret and apply foreign laws.

After carefully considering IIB/SIFMA's comment, the Commission is adopting this aspect of the rule as proposed.[495] In considering IIB/SIFMA's comment, and the broader issue of the Commission's supervision of non-U.S. swap entities, the Commission notes the various manifestations of international comity, deference, and supervisory cooperation presently taking place in the examination practices of the Commission and NFA. As a preliminary matter, the Commission's and NFA's examinations of non-U.S. swap entities occur with appropriate notice and consultation with the relevant foreign authority in the foreign jurisdiction that has primary oversight of the non-U.S swap entity. The Commission continues to be open to further ways to cooperate with such authorities in the supervision of non-U.S. swap entities.

Moreover, the Commission generally relies upon the relevant foreign regulator's oversight of a non-U.S. swap entity in relation to the application of a foreign jurisdiction's standards where a non-U.S. swap entity complies with such standards pursuant to a comparability determination issued by the Commission. To briefly recount these instances, a foreign swap entity may demonstrate compliance with a Commission requirement in group A through substituted compliance (*i.e.*, complying with comparable standards in its home jurisdiction that the Commission has determined to be comparable), regardless of whether the transactions involve a U.S. person.[496] Given the Commission's

[495] Final § 23.23(g)(5).

[496] Moreover, to the extent a foreign swap entity receives substituted compliance for a group A requirement that incorporates § 1.31's recordkeeping requirements for certain regulatory records, § 1.31 would also not apply to such regulatory records.

interest in promoting international comity and market liquidity, the Final Rule allows a non-U.S. swap entity (unless booking a transaction in a U.S. branch or Guaranteed Entity), 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. Further, the Final Rule allows a non-U.S. swap entity, subject to the terms of the relevant comparability determination, to satisfy any applicable group B requirement for any swap booked in a U.S. branch with a foreign counterparty that is neither a foreign branch nor a Guaranteed Entity by complying with an applicable corresponding standard of a foreign jurisdiction. With regard to the group C requirements, the Commission considers that it is generally appropriate to defer to foreign jurisdictions and thus provides an exception from application of the business conduct standards to foreign-based swaps with foreign counterparties. The Commission has also noted above certain exceptions from the group B requirements in the Final Rule for certain foreign-based swaps; non-U.S. swap entities that avail themselves of these exceptions for their eligible 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.

With regard to exams of non-U.S. swap entities and access to their books and records by the Commission and NFA, the general focus is on assessing compliance with any of the Commission's group A requirements for which substituted compliance is not found, group B requirements for transactions involving a U.S. person, and group C requirements as to transactions where the counterparty customer is in the U.S. Both the

Commission and NFA retain examination and enforcement authority over swap entities to assess compliance with any Commission requirements in appropriate circumstances.[497]

3. Effect on Existing Comparability Determinations

In the Proposed Rule, the Commission stated that this rulemaking would not have any impact on the effectiveness of existing Commission comparability determinations that were issued consistent with the Guidance, which would remain effective pursuant to their terms.[498] Three commenters requested that the Commission revisit prior comparability determinations in light of this rulemaking. Specifically, ISDA stated that the Commission should recalibrate existing comparability determinations with the aim of issuing holistic, outcomes-based substituted compliance and clarify in the meantime that existing determinations would continue to be valid under the Commission's new cross-border framework. Further, IIB/SIFMA and JFMC/IBAJ requested that the Commission amend its previously-issued comparability determinations for Australia, Canada, the EU, Hong Kong, Japan, and Switzerland to include § 23.607 (antitrust requirements), which the Commission is adding to the scope of the group A requirements. The Commission has carefully considered these comments and is adopting this aspect of the rule as proposed. The Commission will consider applications to amend existing comparability determinations in due course. However, the Commission will view any previously issued comparability determination that allows for substituted compliance for § 23.201 to also allow for substituted compliance with § 45.2(a) to the extent it duplicates § 23.201.

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[497] A non-U.S. swap entity remains subject to the Commission's anti-fraud and anti-manipulation authority, which may entail access to books and records covering transactions and/or activities not involving a U.S. person.

[498] *See* Proposed Rule, 85 FR at 986.

4. Eligibility Requirements

The Proposed Rule outlined eligibility requirements to allow a comparability determination to be initiated by the Commission itself or certain outside parties, including: (1) swap entities that are eligible for substituted compliance; (2) trade associations whose members are such swap entities; or (3) foreign regulatory authorities that have direct supervisory authority over such swap entities and are responsible for administering the relevant swap standards in the foreign jurisdiction.[499] The Commission did not receive any comments regarding eligibility, and is therefore adopting this aspect of the rule as proposed.[500]

5. Submission Requirements

The Proposed Rule also outlined submission requirements in connection with a comparability determination with respect to some or all of the group A and group B requirements. Specifically, the Proposed Rule stated that 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.[501] Further, the Proposed Rule stated that 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.[502] The Commission did not receive any comments regarding submission requirements, and is

[499] Proposed § 23.23(g)(2); Proposed Rule, 85 FR at 987.

[500] Final § 23.23(g)(2).

[501] Proposed § 23.23(g)(3); Proposed Rule, 85 FR at 987.

[502] Proposed § 23.23(g)(3)(iii); Proposed Rule, 85 FR at 987.

therefore adopting this aspect of the rule substantially as proposed and shown in the rule text in this release.[503] Specifically, to provide the Commission additional information to use in making its comparability determinations, the Commission is revising § 23.23(g)(3)(ii) to require that the submission address how the relevant foreign jurisdiction's standards address the elements or goals of the Commission's corresponding requirements or group of requirements.[504]

VII. Recordkeeping

The Commission proposed to require a SD or MSP to create a record of its compliance with all provisions of the Proposed Rule, and retain those records in accordance with § 23.203.[505] The Commission received no comments on this provision. The Commission is therefore adopting this provision as proposed.[506] The Commission reiterates that 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 Final Rule.

VIII. Other Comments

The Commission received several comments that it considers beyond the scope of this rulemaking.

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[503] Final § 23.23(g)(3).

[504] Final § 23.23(g)(3)(ii).

[505] Proposed § 23.23(h); Proposed Rule, 85 FR at 987.

[506] Final § 23.23(h)(1).

BGC/Tradition, IIB/SIFMA, and ISDA requested that the Commission include certain of the Unaddressed Requirements as group A requirements, group B requirements, and group C requirements.

ISDA requested that the Commission take a number of actions regarding the cross-border application of regulatory reporting requirements prior to finalizing the Proposed Rule. These included codifying an SDR reporting obligation no-action letter (CFTC Staff Letter 17-64),[507] providing substituted compliance for SDR reporting obligations for certain transactions, eliminating the Commission's large trader reporting requirements with respect to certain cross-border transactions, and revisiting the group C requirements in their entirety.

State Street recommended that the Commission address fragmentation of global non-deliverable forward liquidity pools created by Commission rulemaking and guidance in future Commission rulemaking.

JBA requested guidance on how swap requirements will apply to a non-U.S. person that is not a swap entity similar to Appendix F of the Guidance.

BGC/Tradition requested that the Commission confirm that non-U.S. introducing brokers ("IBs") engaged in soliciting or accepting swap orders from customers, including U.S. person SDs, may comply with the applicable rules in the relevant non-U.S. jurisdictions without duplicative regulatory liability under the CEA and Commission regulations. BGC/Tradition requests that the CFTC provide guidance on how these foreign operations may avail themselves of relief through substituted compliance or another form of mutual recognition.

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[507] CS also requested codification of CFTC Staff Letter 17-64.

As noted above, these comments are beyond the scope of this rulemaking. Although not addressed in this rulemaking, the Commission appreciates the information provided by commenters and will take the requests and suggestions under advisement in the context of any relevant future Commission action.

IX. Compliance Dates and Transition Issues

A. Summary of Comments

IIB/SIFMA commented that, if adopted, the Proposed Rule would bring significant changes to portions of the Commission's cross-border framework and thus, the Commission should consider making the following clarifications and conforming changes to ensure an orderly transition process:

1. The Commission should clarify that any no-action relief or guidance that applies to the requirements not addressed in the Proposed Rule will remain effective, and that any no-action letter or guidance not specifically revoked by the Proposed Rule remains in effect.

2. If the Commission plans to amend or revoke any applicable letters, guidance, or other relief not specifically addressed in the Proposed Rule, the Commission should only do so following adequate notice and opportunity for comment.

3. The Commission should grandfather transactions entered into prior to the compliance date of any final cross-border rules adopted by the Commission.

4. The Commission should continue the codification exercise reflected by the Proposed Rule further by codifying the cross-border application of the Unaddressed Requirements.

5. The Commission should delay the compliance date for the changes set forth in the Proposed Rule until it has codified the cross-border application of the swap-related requirements not covered by the Proposed Rule. Until that time, market participants could continue to follow the Guidance.

JBA requested that the Commission clarify as soon as possible the cross-border treatment of other requirements not addressed in the Proposed Rule, and consider harmonizing the timing of application of all requirements such that they are applied simultaneously.

B. Commission Determination

As requested by IIB/SIFMA, the Commission hereby clarifies that any no-action relief or guidance that applies to the Unaddressed Requirements will remain effective, and that any no-action letter or guidance not specifically revoked remains in effect.[508]

Regarding the scope of application of the Final Rule, as requested by commenters the Commission has provided in the Final Rule that it will only apply to swaps entered into on or after the specified compliance date.

The effective date of the Final Rule will be the date that is 60 days after publication of the Final Rule in the *Federal Register*.

The Commission has provided under paragraph (h) of the Final Rule that the exceptions provided in paragraph (e) of the Final Rule will be effective upon the effective date of the rule, provided that SDs and MSPs comply with the recordkeeping requirements set forth in paragraph (h)(1) of the Final Rule.

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[508] As noted in section V, *supra*, the ANE Staff Advisory and related ANE No-Action Relief has been withdrawn contemporaneously with promulgation of the Final Rule, while Commission staff has provided new no-action relief concerning the Unaddressed TLRs in the context of ANE Transactions.

Otherwise, affected market participants must comply with § 23.23 on or before [INSERT DATE 365 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. Given the similarity of the Final Rule to the Guidance with which market participants have been familiar since 2013, the Commission believes that a compliance period of one year is adequate for market participants to come into compliance, especially given that the Final Rule permits reliance on representations received from counterparties pursuant to the Cross-Border Margin Rule and the Guidance for many aspects of the Final Rule.

X. 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.[509] In the Proposed Rule, the Commission certified that the Proposed Rule would not have a significant economic impact on a substantial number of small entities. The Commission received no comments with respect to the RFA.

The Commission previously established definitions of "small entities" to be used in evaluating the impact of its regulations on small entities in accordance with the RFA.[510] The Final Rule addresses when U.S. persons and non-U.S. persons are required to include their cross-border swap dealing transactions or swap positions in their SD or

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[509] *See* 5 U.S.C. 601 *et seq*.

[510] *See* Policy Statement and Establishment of Definitions of "Small Entities" for Purposes of the Regulatory Flexibility Act, 47 FR 18618 (Apr. 30, 1982) (finding that DCMs, FCMs, CPOs, and large traders are not small entities for RFA purposes).

MSP registration threshold calculations, respectively,[511] and the extent to which SDs or MSPs are required to comply with certain of the Commission's regulations in connection with their cross-border swap transactions or swap positions.[512]

The Commission previously determined that SDs and MSPs are not small entities for purposes of the RFA.[513] 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 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.[514]

To the extent that there are any affected small entities under the Final Rule, they would need to assess how they are classified under the Final Rule (*i.e.*, U.S. person, SRS,

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[511] Final § 23.23(b) through (d).

[512] Final § 23.23(e) through (g).

[513] *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).

[514] 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 are affected by the Final Rule are generally large financial institutions or other large entities that are required to include their cross-border dealing transactions or swap positions toward the SD and MSP registration thresholds, respectively, as specified in the Final Rule.

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 or MSP under the Final Rule. The Commission believes that, with the adoption of the Final Rule, market participants will 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 Final Rule.[515]

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

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 ("PRA")[516] 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 Final Rule provides for the cross-border application of the SD and MSP registration thresholds and the group A, group B, and group C requirements.

Commission regulations 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

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[515] The Final Rule addresses the cross-border application of the registration and certain other regulations. The Final Rule does not change such regulations.

[516] 44 U.S.C. 3501 *et seq*.

SDs or MSPs. However, the Commission believes that the Final Rule will not result in any new registered SDs or MSPs or the deregistration of registered SDs,[517] and therefore, it does not believe an amendment to any existing collection of information is necessary as a result of § 23.23(b) and (c). Specifically, the Commission does not believe the Final Rule will 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, § 23.23(h)(1) contains collection of information requirements within the meaning of the PRA as it requires that swap entities create a record of their compliance with § 23.23 and retain records in accordance with § 23.203; however, 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, and 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

[517] There are not currently any registered MSPs.

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.[518] Accordingly, the Commission is not submitting to OMB an information collection request to create a new information collection in relation to § 23.23(h)(1).

Final § 23.23(g) results in collection of information requirements within the meaning of the PRA, as discussed below. The Final Rule contains collections of information for which the Commission has not previously received control numbers from the OMB. Responses to this collection of information are 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 Final Rule.

As discussed in section VI.C above, the Commission is permitting 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. Commission

[518] To the extent a swap entity avails itself of an exception from a group B or group C requirement under the Final 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.

regulation 23.23(g) implements a process pursuant to which the Commission will 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.[519] Applicants seeking a comparability determination are 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 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.[520] The information collection is necessary for the Commission to consider whether the foreign jurisdiction's relevant swap standards are comparable to the Commission's requirements.

Though under the Final Rule many entities are eligible to request a comparability determination,[521] the Commission expects to receive far fewer requests because once a comparability determination is made for a jurisdiction it applies 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

[519] Final § 23.23(g)(2).

[520] Final § 23.23(g)(3).

[521] Currently, there are approximately 108 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.

European Union, Hong Kong, Japan, and Switzerland,[522] and the effectiveness of those determinations is not affected by the Final Rule. Nevertheless, in an effort to be conservative in its estimate for purposes of the PRA, the Commission estimates that it will receive a request for a comparability determination in relation to five (5) jurisdictions per year under the Final Rule. 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 changes are estimated to 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 made by the Final Rule and current burden not affected by this Final Rule,[523] 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. In the Proposed Rule, the Commission requested comments on the information collection requirements discussed above, including, without limitation, on the Commission's discussion of the estimated burden of

[522] *See supra* notes 215 and 484.

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

the collection of information requirements in proposed § 23.23(h) (§ 23.23(h)(1) in the Final Rule). The Commission did not receive any such comments.

C. Cost-Benefit Considerations

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

Since issuing the Proposed Rule, the baseline against which the costs and benefits of the Final Rule are considered is unchanged and 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 Final 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 the 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 Final Rule and the discussion in this preamble, the Final 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.[524] 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.[525]

Fourth, the Commission staff has issued several interpretive and no-action letters that are relevant to cross-border issues.[526] As with the Guidance, the Commission recognizes that many market participants have relied on these staff letters in framing their business practices.

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[524] *See supra* notes 215 and 484.

[525] *See id*.

[526] *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; CFTC Staff Letter No. 18-13.

Fifth, as noted above, the international regulatory landscape is far different now than it was when the Dodd-Frank Act was enacted in 2010.[527] 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, 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 Final Rule that are 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.

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 Final 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 Final 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 will be binding legal requirements under the Final Rule; (2) does so now for the first time; or (3) did so in stages as international requirements evolved.

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[527] *See supra* section I.C.

In light of these considerations and given that there were no public comments regarding the baseline outlined in the Proposed Rule, the Commission has considered costs and benefits by focusing primarily on two types of information and analysis.

First, the Commission compared the Final Rule with current business practices, with the understanding that many market participants are now conducting business taking into account, among other things, the Guidance, applicable CFTC staff letters, and existing comparability determinations. This approach, for example, included a comparison of the expected costs and benefits of conducting business under the Final Rule with those of conducting business in conformance with analogous provisions of the Guidance. In effect, this analysis included an examination of new costs and benefits that will result from the Final Rule for market participants that are currently following the relevant Dodd-Frank Act swap provisions and regulations thereunder, the Guidance, the comparability determinations, the Cross-Border Margin Rule, and applicable staff letters. This is referred to as "Baseline A."

Second, to the extent feasible, the Commission considered relevant information on costs and benefits that market participants have incurred to date in complying with the Dodd-Frank Act in cross-border transactions of the type that will be affected by the Final Rule, absent the Guidance. This second form of analysis 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 Final Rule. However, since a theoretically perfect baseline for consideration of costs and benefits does not appear feasible, this second form of analysis helps ensure that costs and benefits of the Final Rules are considered as fully as possible. This is referred to as "Baseline B."

The Commission requested comments regarding all aspects of the baselines applied in this consideration of costs and benefits, including a discussion of any variances or different circumstances commenters have experienced that affect the baseline for those commenters. While no commenters questioned the Commission's defined baseline, the Commission received a few cost-benefit related comments that are addressed in the relevant sections of this discussion.

The costs associated with the key elements of the Commission's cross-border approach to the SD and MSP registration thresholds – requiring market participants to classify themselves as U.S. persons, Guaranteed Entities, or SRSs[528] and to apply the rules accordingly – fall into a few categories. Market participants will 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 Final Rule will also incur costs associated with complying with the relevant Dodd-Frank Act requirements applicable to registrants, such as the capital, margin, and business conduct requirements ("programmatic costs").[529] While only new registrants will assume these programmatic

[528] Final § 23.23(a).

[529] 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 will

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 Final Rule.

In developing the Final 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 toward its SD de minimis calculation. Therefore, SRSs are 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.[530] On the other hand, 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 Final 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

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change as a result of the Final Rule being adopted given the general similarities between the Final Rule's approach to the MSP registration threshold calculations and the Guidance.

[530] 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.

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 effect of the Final Rule. The Commission expects that such effects will be mitigated as the Commission continues to work with foreign and domestic regulators to achieve international harmonization and cooperation.

In the sections that follow, the Commission discusses the costs and benefits associated with the Final Rule.[531] Section 1 discusses the main benefits of the Final Rule. Section 2 begins by addressing the assessment costs associated with the Final Rule, which derive in part from the defined terms used in the Final Rule (*e.g.*, the definitions of "U.S. person," "significant risk subsidiary," and "guarantee"). Sections 3 and 4 consider the costs and benefits associated with the Final Rule's determinations regarding how each classification of market participants applies to the SD and MSP registration thresholds, respectively. Sections 5, 6, and 7 address the monitoring, registration, and programmatic costs associated with the Final Rule's cross-border approach to the SD (and, as appropriate, MSP) registration thresholds, respectively. Section 8 addresses the costs and benefits associated with the Final Rule's exceptions from, and available substituted compliance for, the group A, group B, and group C requirements, as well as comparability determinations. Section 9 addresses the costs associated with the Final

[531] The Commission endeavors to assess the expected costs and benefits of its 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 Final Rule is generally provided in qualitative terms.

Rule's recordkeeping requirements. Section 10 discusses the factors established in section 15(a) of the CEA.

1. Benefits

The main benefits of the Final Rule are two-fold: (1) legal certainty; and (2) creating and continuing to maintain a harmonized regulatory framework internationally that shows deference to other countries' laws and regulations when such laws and regulations achieve comparable outcomes, a construct known as comity. The clarity of the Final Rule makes it easier for market participants to comply with the Commission's regulations, to conduct business in a well-organized, efficient way, and to re-allocate resources from compliance to other areas, such as productivity, business development, and innovation.

Congress directed the Commission in the Dodd-Frank Act to "coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation" of swaps and SDs and MSPs.[532] In doing so, the Commission is acting in the public interest and employing comity as one of the justifications for the choices the Commission is making in the Final Rule. For example, the provision of substituted compliance in the Final Rule allows some market participants to elect a regulatory jurisdiction that best suits their needs. Accordingly, some market participants may choose the U.S. as a jurisdiction in which to register and operate to achieve benefits such as robust SD requirements, third-party custodial arrangements, transparent exchanges, and bankruptcy regimes that have strong property rights and tend to lead to assets being recovered sooner than some other regimes. Therefore, the

[532] *See* Dodd-Frank Act, section 752(a); 15 U.S.C. 8325.

Commission believes that substituted compliance may lead to more effective regulation over time as regulators are incentivized to have their jurisdiction be chosen over other jurisdictions, and to modify ineffective or inefficient regulation as needed to adapt to market innovations and other changes that occur over time. The Commission recognizes, however, that such provision may present an opportunity for regulatory arbitrage, which could undermine the fundamental principles of the reduction of systemic risk and the promotion of market integrity.

2. Assessment Costs

As discussed above, in applying the Final Rule's cross-border approach to the SD and MSP registration thresholds, market participants are 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 will 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 Final Rule's definition of "U.S. person"). Harmonizing the "U.S. person" definition in the Final Rule with the definition in the SEC Cross-Border Rule is also expected to reduce undue compliance costs for market participants. Additionally, the Final Rule allows market participants to rely on representations from their counterparties with regard to their classifications.[533] However, the Commission acknowledges that swap entities will have to modify their existing operations to accommodate the new concept of an SRS. Specifically, market participants must determine whether they qualify as SRSs. Further, in order to rely on certain exceptions outlined in the Final Rule, swap entities must ascertain whether they or their counterparty qualify as an SRS.

With respect to Baseline B, wherein only certain market participants have previously determined their status under the similar, but not identical, Cross-Border Margin Rule (and not the Guidance), the Commission believes that their assessment costs will nonetheless be small as a result of the Final Rule's reliance on clear, objective definitions of the terms "U.S. person," "significant risk subsidiary," and "guarantee." Further, with respect to the determination of whether a market participant falls within the "significant risk subsidiary" definition,[534] the Commission believes that assessment costs are 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, 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 § 23.23(a)(13)(i) or (ii) of the Final Rule must consider if they are an SRS.

Additionally, the Final Rule primarily 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

[533] 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.

[534] The "substantial risk subsidiary" definition is discussed further in section II.D, *supra*.

counterparty's obligations under the swap.[535] The Final Rule also incorporates the concept of an entity with unlimited U.S. responsibility into the guarantee definition; however, 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. Therefore, although non-U.S. persons must determine 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 is already known by non-U.S. persons.[536] Accordingly, with respect to both baselines, the Commission believes that the costs associated with assessing whether an entity or its counterparty is a Guaranteed Entity is small and incremental.

Better Markets commented that the proposed definition of "guarantee," which was narrower than that in the Guidance, would increase systemic risk and hinder other public interest objectives by possibly excluding certain arrangements that may import risk into the United States. In the Proposed Rule, the Commission stated that the alignment of the definitions of "guarantee" in this rulemaking and the Cross-Border Margin Rule would benefit market participants to the extent that they would not be required to make a separate independent assessment of a counterparty's guarantee status. Better Markets stated that this benefit to market participants does not outweigh or reasonably approximate the potential costs to the underlying policy objectives of the Dodd-Frank Act, including promoting the safety and soundness of SDs, preventing

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[535] *See supra* section II.C.

[536] 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.

disruptions to the derivatives markets, ensuring the financial integrity of swaps transactions and the avoidance of systemic risk, and preserving the stability of the U.S. financial system. The Commission has carefully considered the attendant costs and benefits of narrowing the definition of "guarantee" from the Guidance, and continues to believe, however, that the alignment of the "guarantee" definitions in this Final Rule and the Cross-Border Margin Rule serves to reduce costs to market participants without sacrificing the attendant policy goals of the Dodd-Frank Act. The Commission will continue to monitor arrangements that were previously considered guarantees that could shift risk back to the U.S. swap market, in general, and take appropriate action as warranted in the future.

3. Cross-Border Application of the SD Registration Threshold

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

Under the Final Rule, a U.S. person must include all of its swap dealing transactions in its de minimis calculation, without exception.[537] As discussed above, that includes any swap dealing transactions conducted through a U.S. person's foreign branch, as such swaps are directly attributed to, and therefore affect, the U.S. person. Given that this requirement mirrors the Guidance in this respect, the Commission believes that the Final Rule will have a negligible effect on the status quo with regard to the number of registered or potential U.S. SDs, as measured against Baseline A.[538] With respect to

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[537] Final § 23.23(b)(1).

[538] 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 will result from the Final Rule's definition of U.S. person and therefore assumes that no additional entities will register as U.S. SDs, and no existing U.S.-SD registrants will deregister as a result of the Final Rule.

Baseline B, all U.S. persons would have included all of their transactions in their de minimis calculation, even absent the Guidance, pursuant to paragraph (4) of the SD definition.[539] 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 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 Final Rule also requires Guaranteed Entities to include all of their swap dealing transactions in their de minimis threshold calculation without exception.[540] This approach, which recognizes that a Guaranteed Entity's swap dealing transactions may have the same potential to affect 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."[541] Given that the Final Rule establishes 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

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

[540] Final § 23.23(b)(2)(ii).

[541] While the Final 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 Final 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 definition of "guarantee" in the Final Rule is not limited to uncleared swaps, and also now incorporates the concept of "unlimited U.S. responsibility." *See supra* section II.C.

does not expect that the Final Rule will cause more Guaranteed Entities to register with the Commission. Accordingly, the Commission believes that, in this respect, any increase in costs associated with the Final Rule, with respect to Baselines A and B, will be small.

Under the Final Rule, an SRS must include all swap dealing transactions in its de minimis threshold calculation.[542] Given that the concept of an SRS was not included in the Guidance or the Cross-Border Margin Rule, the Commission believes that this aspect of the Final Rule will have a similar effect 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 a non-U.S. person that is neither a conduit affiliate nor a guaranteed affiliate (which would have been required to count only a subset of its dealing swaps towards its de minimis threshold calculation). Accordingly, under the Final Rule, there may be some SRSs that will 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.D and III.B.1, the Commission believes that it is 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, 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 their relationships with their ultimate U.S. parent entities. Of the 61 non-U.S. SDs that were provisionally registered

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[542] Final § 23.23(b)(1).

with the Commission as of July 2020, the Commission believes that few, if any, will be classified as SRSs pursuant to the Final Rule. With respect to Baseline A, any potential SRSs would have likely classified themselves as a conduit affiliate or a non-U.S. person that is neither a conduit affiliate nor a guaranteed affiliate 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) so as 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 will incur the incremental costs associated with the additional SRS counting requirements contained in the Final Rule. The Commission believes that the SRS de minimis calculation requirements will 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 will benefit the swap market by ensuring that the Dodd-Frank Act swap provisions addressed by the Final Rule are applied specifically to entities whose activities, in the aggregate, have a direct and significant connection to, and effect on, U.S. commerce.

(ii) Other Non-U.S. Persons

Under the Final Rule, non-U.S. persons that are neither Guaranteed Entities nor SRSs are 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.[543] The Final Rule does not, however, require Other Non-U.S. Persons to include swap dealing transactions with: (1) Guaranteed Entities that are SDs; (2) Guaranteed Entities that are affiliated with an SD and are also below the de minimis threshold; (3) Guaranteed Entities that are guaranteed by a non-financial entity; (3) SRSs (other than SRSs that are also Guaranteed Entities and no other exception applies); or (4) Other Non-U.S. Persons. Additionally, Other Non-U.S. Persons are not 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 through a registered or exempt DCO.

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, will not evade the Dodd-Frank Act regime.

Given that these requirements are consistent with the Guidance in most respects, the Commission believes that the Final Rule will have a negligible effect 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

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[543] Final § 23.23(b)(2).

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 will incur the incremental costs associated with the counting requirements for Other Non-U.S. Persons contained in the Final Rule.

The Commission recognizes that the Final 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 will be required to include all of their swap dealing transactions in their de minimis threshold calculations. In contrast, Other Non-U.S. Persons will 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 will apply toward the de minimis threshold (and thereby trigger SD registration) relative to Other Non-U.S. Persons.[544] While the Commission does not believe that any additional Other Non-U.S. Persons will be required to register as a SD under the Final 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.[545] Additionally, unregistered non-U.S. dealers may be able to offer swaps on

[544] 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.

[545] 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.

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.[546]

As noted above, however, the Commission believes that these competitive disparities will 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 will be negligible.[547] Further, as discussed below, the Commission is adopting a flexible standard of review for comparability determinations relating to the group A and group B requirements that will be issued pursuant to the Final Rule, which will 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 Final 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.

(iii) Aggregation Requirement

The Final Rule also addresses the cross-border application of the aggregation requirement in a manner consistent with the Entities Rule and CEA section 2(i). Specifically, 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 amount of any swap dealing transactions entered into by

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[546] 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.

[547] *See supra* notes 215 and 484.

its affiliates under common control. 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. In general, 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) have to register as an SD so that the relevant swap dealing activity of the unregistered affiliates remains below the threshold. The Commission's approach ensures that the aggregate gross notional amount of applicable swap dealing transactions of all such unregistered U.S. and non-U.S. affiliates does not exceed the de minimis level.

Given that this approach is consistent with the Guidance, the Commission believes that market participants will only incur incremental costs with respect to Baseline A in modifying their existing systems and policies and procedures in response to the Final Rule. Absent the Guidance, the Commission believes that most market participants would have relied on the interpretation of the aggregation requirement in the Entities Rule, which is similar to the approach set forth in the Final Rule. Accordingly, with respect to Baseline B, the Commission believes that market participants will only incur incremental costs in modifying their existing systems and policies and procedures in response to the Final Rule.

4. Cross-Border Application of the MSP Registration Thresholds

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

The Final Rule's approach to the cross-border application of the MSP registration thresholds closely mirrors the approach for the SD registration threshold. Under the Final Rule, a U.S. person must include all of its swap positions in its MSP thresholds, without exception.[548] As discussed above, that includes any swap conducted through a U.S. person's foreign branch, as such swaps are directly attributed to, and therefore affect, the U.S. person. Given that this requirement is consistent with the Guidance in this respect, the Commission believes that the Final Rule will have a minimal effect 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 calculations, even absent the Guidance, pursuant to paragraph (6) of the MSP definition.[549] 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 swaps conducted through their foreign branches in their MSP threshold calculations. 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 Final Rule also requires Guaranteed Entities to include all of their swap positions in their MSP threshold calculations without exception.[550] This approach, which recognizes that such swap transactions may have the same potential to affect the U.S.

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[548] Final § 23.23(c)(1).

[549] 17 CFR 1.3, Major swap participant, paragraph (6).

[550] Final § 23.23(c)(2)(ii).

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."[551] The Commission believes that few, if any, additional MSPs will qualify as Guaranteed Entities pursuant to the Final Rule, as compared to Baseline A. Accordingly, the Commission believes that, in this respect, any increase in costs associated with the Final Rule will be small.

Under the Final Rule, an SRS must also include all of its swap positions in its MSP threshold calculations.[552] 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 calculations) or a non-U.S. person that is neither a conduit affiliate nor a guaranteed affiliate (which would have been required to count only a subset of its swap positions towards its MSP threshold calculations). Unlike an Other Non-U.S. Person, SRSs will additionally be required to include in their MSP threshold calculations any transaction that is executed anonymously on a DCM, registered or exempt SEF, or registered FBOT, and cleared through a registered or exempt DCO.

As noted in sections II.D and IV.B.1, the Commission believes that it is appropriate to distinguish SRSs from Other Non-U.S. Persons in determining the cross-border application of the MSP thresholds to such entities, as well as with respect to the Dodd-Frank Act swap provisions addressed by the Final Rule more generally. As discussed above, SRSs, as a class of entities, present a greater supervisory interest to the

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[551] *See* Guidance, 78 FR at 45319-45320.

[552] Final § 23.23(c)(1).

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 calculations than Other Non-U.S. Persons do. 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 Final Rule will have a similar effect 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 will be required to undertake an assessment to determine whether they would qualify as an MSP under the Final Rule. Any such entities would likely have classified themselves as a non-U.S. person that is neither a conduit affiliate nor a guaranteed affiliate 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 calculations. Accordingly, such SRSs will incur the incremental costs associated with the additional SRS counting requirements contained in the Final Rule. The Commission believes that these SRS calculation requirements will 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 will benefit the swap market by ensuring that the Dodd-Frank Act swap requirements that are addressed by the Final Rule are applied to entities whose activities have a direct and significant connection to, or effect on, U.S. commerce.

(ii) Other Non-U.S. Persons

Under the Final Rule, Other Non-U.S. Persons are 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.[553] The Final Rule does not, however, require Other Non-U.S. Persons to include swap positions with a Guaranteed Entity that is an SD, SRSs (other than SRSs that are also Guaranteed Entities and no other exception applies), or Other Non-U.S. Persons. Additionally, Other Non-U.S. Persons will not be required to include in their MSP threshold calculations any transaction that is executed anonymously on a DCM, a registered or exempt SEF, or registered FBOT, and cleared through a registered or exempt DCO.[554]

Given that these requirements are consistent with the Guidance in most respects, the Commission believes that the Final Rule will have a minimal effect 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

[553] Final § 23.23(c)(2).

[554] Final § 23.23(d).

them to count swaps with non-U.S. persons toward their MSP threshold calculations. Accordingly, such non-U.S. persons will incur the incremental costs associated with the counting requirements for Other Non-U.S. Persons contained in the Final Rule.

The Commission recognizes that the Final Rule's cross-border approach to the MSP threshold calculations 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 will be required to include all of their swap positions. In contrast, Other Non-U.S. Persons will 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 will 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 will be required to register as MSPs under the Final Rule, the Commission acknowledges that to the extent that a currently unregistered non-U.S. person is required to register as an MSP under the Final Rule, its non-U.S. person counterparties may possibly cease transacting with it in order to operate outside the Dodd-Frank Act swap regime.[555] 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.[556] As noted above, however, the Commission believes that these competitive disparities will be

[555] 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.

[556] 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.

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 thresholds taken in the Final 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.

(iii) Attribution Requirement

The Final Rule also addresses 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. Specifically, 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 is not required if the entity that enters into the swap directly is subject to capital regulation by the Commission or the SEC, is regulated as a bank in the United States, or is subject to Basel compliant capital standards and oversight by a G20 prudential supervisor. The Final Rule also clarifies that the swap positions of an entity that is required to register as an MSP, or whose MSP registration is pending, is not subject to the attribution requirement. Given that this approach is largely consistent with the Guidance, with certain caveats, the Commission believes that market participants will only incur incremental costs with respect to Baseline A in modifying their existing systems and policies and procedures in response to the Final Rule. Absent the Guidance, the Commission believes that most market participants would have relied on the interpretation of the attribution requirement in the Entities Rule, which is similar to the approach set forth in the Final Rule. Accordingly, with respect to Baseline B, the Commission believes that market participants will only incur incremental costs in modifying their existing systems and policies and procedures in response to the Final Rule. In addition, the Commission believes that consistency with the approach in the SEC Cross-Border Rule will reduce compliance costs for market participants.

5. Monitoring Costs

Under the Final Rule, market participants must 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 will only incur incremental costs in modifying their existing systems and policies and procedures in response to the Final Rule (*e.g.*, determining which swap activities or positions are required to be included in the registration threshold calculations).[557]

For example, with respect to the SD registration threshold, 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 will be required under the Final Rule to include all dealing swaps in its de minimis calculation, the

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[557] Although the cross-border approach to the MSP registration threshold calculations in the Final Rule is not identical to the approach included in the Guidance (*see supra* section IV.B), the Commission believes that any resulting increase in monitoring costs resulting from the adoption of the Final Rule will be incremental and de minimis.

Commission believes that any increase in monitoring costs for SRSs will 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.[558] The Commission expects that any adjustments made to these systems in response to the Final Rule will 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. Accordingly, such persons will incur the incremental costs in modifying their existing systems and policies and procedures in response to the Final Rule to monitor their swap activity with certain non-U.S. persons. To the extent that market participants did not interpret CEA section 2(i) in such manner, they will incur more substantial costs in implementing such monitoring activities.

6. Registration Costs

With respect to Baseline A, the Commission believes that few, if any, additional non-U.S. persons will be required to register as an SD pursuant to the Final 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 could be required to register with the Commission pursuant to the Final Rule.

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[558] *See supra* section X.C.2, for a discussion of assessment costs.

The Commission acknowledges that if a market participant is required to register, it will incur registration costs. The Commission previously estimated registration costs in its rulemaking on registration of SDs;[559] however, the costs that may be incurred should be mitigated to the extent that any 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 will 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 will be required to register as an MSP under the Final Rule, as noted above.

7. Programmatic Costs

With respect to Baseline A, as noted above, the Commission believes that few, if any, additional non-U.S. persons will be required to register as an SD under the Final 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 could be required to register with the Commission pursuant to the Final Rule.

To the extent that the Final Rule acts as a "gating" rule by affecting which entities engaged in cross-border swap activities must comply with the SD requirements, the Final

[559] *See* Registration of Swap Dealers and Major Swap Participants, 77 FR at 2623-2625.

Rule will result in increased costs for particular entities that otherwise would not register as an SD and comply with the swap requirements.[560]

8. 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 adopting 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 Final Rule includes: (1) the Exchange-Traded Exception from certain group B and group C requirements for certain 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 U.S. Branch Group C Exception, for swaps booked in a U.S. branch with certain foreign counterparties; (4) the Limited Foreign Branch Group B Exception for certain foreign-based swaps of foreign branches of U.S. swap entities with certain foreign counterparties; (5) the Non-U.S. Swap Entity Group B Exception for foreign-based swaps of non-U.S. swap entities that are Other Non-U.S. Persons with certain foreign counterparties; and (6) the Limited Swap Entity SRS/Guaranteed Entity Group B Exception for certain foreign-based swaps of SRS Swap Entities and Guaranteed Swap Entities with certain foreign counterparties.

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

Under the Final Rule, U.S. swap entities (other than their foreign branches) are not excepted from, or eligible for substituted compliance for, the Commission's group A, group B, and group C requirements. These requirements 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 will 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 are generally excepted from most of the group B and group C requirements with respect to their foreign-based swaps that are executed anonymously on a DCM, a registered or exempt SEF, or registered FBOT, and cleared through a registered or exempt DCO.

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

Under the U.S. Branch Group C Exception, a non-U.S. swap entity is excepted from the group C requirements with respect to any swap booked in a U.S. branch with a foreign counterparty that is neither a foreign branch nor a Guaranteed Entity.

Pursuant to the Limited Foreign Branch Group B Exception, foreign branches of U.S. swap entities are excepted from the group B requirements, with respect to any foreign-based swap with a foreign counterparty that is an SRS End User or an Other Non-

U.S. Person that is not a swap entity, subject to certain conditions: Specifically, (1) a group B requirement is not eligible for the exception if the requirement, as applicable to the swap, is eligible for substituted compliance pursuant to a comparability determination issued by the Commission prior to the execution of the swap; and (2) in any calendar quarter, the aggregate gross notional amount of swaps conducted by a swap entity in reliance on this exception does not exceed five percent of the aggregate gross notional amount of all its swaps.

In addition, pursuant to the Non-U.S. Swap Entity Group B Exception, non-U.S. swap entities that are Other Non-U.S. Persons are excepted from the group B requirements with respect to any foreign-based swap with a foreign counterparty that is an SRS End User or Other Non-U.S. Person.

Finally, pursuant to the Limited Swap Entity SRS/Guaranteed Entity Group B Exception, each Guaranteed Swap Entity and SRS Swap Entity is excepted from the group B requirements, with respect to any foreign-based swap with a foreign counterparty that is an SRS End User or an Other Non-U.S. Person that is not a swap entity, subject to certain conditions. Specifically, under the Final Rule: (1) the exception is not available with respect to any group B requirement if the requirement as applicable to the swap is eligible for substituted compliance pursuant to a comparability determination issued by the Commission prior to the execution of the swap; and (2) in any calendar quarter, the aggregate gross notional amount of swaps conducted by an SRS Swap Entity or a Guaranteed Swap Entity in reliance on this exception aggregated with the gross notional amount of swaps conducted by all affiliated SRS Swap Entities and Guaranteed Swap Entities in reliance on this exception does not exceed five percent of the aggregate gross notional amount of all swaps entered into by the SRS Swap Entity or a Guaranteed Swap Entity and all affiliated swap entities.

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. For example, the Final Rule generally requires non-U.S. swap entities that are 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.[561] However, the Commission believes that the exceptions from the group B requirements in the Final Rule, coupled with the availability of substituted compliance, will help to alleviate any additional burdens that may arise from such application. Further, the group C requirements have been expanded to include Subpart L, which consequently expands the scope of certain of the exceptions from the group C requirements under the Final Rule. 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 exceptions will 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). Swap entities are

[561] The group B requirements were categorized as Category A transaction-level requirements under the Guidance.

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.[562]

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, by providing the exceptions in the Final Rule. 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. Other than the U.S. Branch Group C Exception, the exceptions in the Final Rule are largely similar to those provided in the Guidance. Therefore, the Commission does not expect that the exceptions in the Final Rule will, in the aggregate, have a significant effect 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 Final Rule depends 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 substituted compliance carries certain trade-offs. Given the global and highly-interconnected nature of the swap market, where risk is not bound by

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

national borders, market participants are likely to be subject to the regulatory interest of more than one jurisdiction. Allowing compliance with foreign swap standards 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. 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 substituted compliance is 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 substituted compliance regime for the group A and group B requirements and has determined that the Final Rule will enhance market efficiency and foster 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 Final Rule 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 its 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.[563]

Nevertheless, the Commission does not believe it is appropriate to make substituted compliance broadly available to all swap entities because it needs to protect market participants and the public. As discussed above, the Commission has a strong supervisory interest in the swap activity of all swap entities, 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 Final Rule. With respect to non-U.S. swap entities, however, the Commission believes that, in the interest of international comity, making substituted compliance generally available for the requirements discussed in the Final Rule is appropriate.

[563] The Commission recognizes that its substituted compliance framework 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.

IATP stated that the Commission should not make the costs of complying with, or economic benefits from, substituted compliance a decision criterion for comparability determinations, and that participation in U.S. markets is a privilege with consequent costs and benefits. Such costs and benefits drive the underlying policy of the substituted compliance regime as discussed in this Final Rule, rather than the decision-making that accompanies an individual comparability determination assessment.

(iii) Comparability Determinations

As noted in section VI.D above, under the Final 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.[564] Once a comparability determination is made for a jurisdiction, it applies for all entities or transactions in that jurisdiction to the extent provided in the determination, as approved by the Commission.[565] Accordingly, given that the Final Rule will have no effect on any existing comparability determinations, swap entities may continue to rely on such determinations with no effect on the costs or benefits of such reliance. To the extent that an entity wishes to request a new comparability determination pursuant to the Final Rule, it will incur costs associated with the preparation and filing of a submission request. However, the Commission anticipates that a person would not elect to incur the costs of

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[564] Final § 23.23(g)(2).

[565] Final § 23.23(f).

submitting a request for a comparability determination unless such costs were exceeded by the cost savings associated with substituted compliance.

The Final 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 standard is comparable to a corresponding Commission requirement, the Final Rule allows 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, 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 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.

9. Recordkeeping

The Final Rule also requires swap entities to create and retain records of their compliance with the Final Rule.[566] Given that swap entities are already subject to robust recordkeeping requirements, the Commission believes that swap entities will only incur incremental costs, which are expected to be minor, in modifying their existing systems

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[566] Final § 23.23(h)(1).

and policies and procedures resulting from changes to the status quo made by the Final Rule.

10. Alternatives Considered

The Commission carefully considered several alternatives to various provisions of the Final Rule. In determining whether to accept or reject each alternative, the Commission considered the potential costs and benefits associated with each alternative.

For example, the Commission considered Better Markets' suggestion that the Commission add two additional tests to determine whether an entity is a significant subsidiary. Better Markets proposed that if an entity were to meet a risk transfer test, measuring the notional amount of swaps that are back-to-backed with U.S. entities, or a risk acceptance test, measuring the trading activity of the subsidiary over a three month time period, then the entity should be considered a significant subsidiary. The Commission declined to include these two tests because these activity-based tests do not provide a measure of risk that a subsidiary poses to a parent entity, and thus would potentially subject a greater number of entities to certain Commission regulations without providing a significant reduction in systemic risk.

Similarly, the Commission considered IIB/SIFMA's comment that the application of the group B requirements to swaps of Guaranteed Swap Entities and SRS Swap Entities should conform to the Guidance, so as to reduce the competitive disadvantages faced by such swap entities and their counterparties when they are subject to U.S. rules extraterritorially. The Commission declined to adopt this alternative, citing the fact that the group B requirements relate to risk mitigation, and SRS Swap Entities and Guaranteed Swap Entities may pose significant risk to the United States. However, the

Commission acknowledged the potential competitive disadvantages that such application may pose to Guaranteed Swap Entities and SRS Swap Entities (as opposed to foreign branches of U.S. swap entities), and therefore also adopted the Limited Swap Entity SRS/Guaranteed Entity Group B Exception in an effort to reduce potential burdens to such entities without sacrificing the important risk mitigation goals associated with the group B requirements.

On the other hand, the Commission adopted certain alternatives to elements of the Proposed Rule. For example, CS and IIB/SIFMA stated that the exclusion for subsidiaries of BHCs in the SRS definition should be expanded to include those entities that are subsidiaries of IHCs. These commenters noted that IHCs are subject to prudential regulation, including Basel III capital requirements, stress testing, liquidity, and risk management requirements. The Commission determined that IHCs are subject to prudential standards by the Federal Reserve Board that are similar to those to which BHCs are subject. In general, IHCs and BHCs of similar size are subject to similar liquidity, risk management, stress testing, and credit limit standards. Therefore, for the same risk-based reasons that the Commission proposed to exclude subsidiaries of BHCs from the definition of SRS, the Commission is expanding the SRS exclusion to include subsidiaries of both BHCs and IHCs in § 23.23(a)(13)(i).

The Commission is also adopting an alternative raised by IIB/SIFMA, who recommended that the Commission expand the proposed Non-U.S. Swap Entity Group B Exception and the Limited Foreign Branch Group B Exception by applying the exceptions to swaps with an SRS that is not a swap entity, so as to avoid inappropriately burdening the foreign subsidiaries of U.S. multinational corporations and their counterparties. In doing so, the Commission acknowledges that applying the group B requirements to a swap entity's swaps indirectly affects their counterparties, including SRS End User counterparties, by requiring them to execute documentation (*e.g.*, compliant swap trading relationship documentation), and engage in portfolio reconciliation and compression exercises as a condition to entering into swaps with swap entity counterparties. Accordingly, mandating compliance with these obligations may cause counterparties, including SRS End Users, to face increased costs relative to their competitors not affected by the application of the group B requirements (*e.g.*, for legal fees or as a result of costs being passed on to them by their swap entity counterparties) and/or to potentially lose access to key interest rate or currency hedging products. Also, because the SRS test depends on a non-U.S. counterparty's internal organizational structure and financial metrics and it would be difficult to rule out any category of non-U.S. counterparties as being an SRS, the proposed application of group B requirements to all SRSs may cause swap entities to obtain SRS representations from nearly their entire non-U.S. client bases, potentially increasing costs for all of these clients.

In light of the importance of ensuring that an SRS, particularly a commercial or non-financial entity, continues to have access to swap liquidity for hedging or other non-dealing purposes, the Commission expanded the exceptions to apply to SRS End Users. The Commission noted that an SRS End User does not pose as significant a risk to the United States as an SRS Swap Entity or a Guaranteed Entity, because an SRS End User: (1) has a less direct connection to the United States than a Guaranteed Entity; and (2) has been involved, at most, in only a de minimis amount of swap dealing activity, or has swap positions below the MSP thresholds, such that it is not required to register as a SD or MSP, respectively.

The Commission considered several other alternatives to the Final Rule, which are discussed in detail throughout this release.[567] In each instance, the Commission considered the costs and burdens of the Final Rule and the regulatory benefits that the Final Rule seeks to achieve.

11. Section 15(a) Factors

Section 15(a) of the CEA[568] 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 Final Rule will 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 Final Rule's approach to the cross-border application of the SD and MSP registration threshold calculations works to ensure that, consistent with CEA section 2(i) and the policy

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[567] *See supra* sections II-VI.

[568] 7 U.S.C. 19(a).

objectives of the Dodd-Frank Act, significant participants in the U.S. market are subject to these requirements. The cross-border approach to the group A, group B, and group C requirements similarly ensures that these requirements 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 Final Rule leads additional entities to register as SDs or MSPs, the Commission believes that the Final Rule will 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 the Final 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 Final 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 extent possible. The Commission further believes that the Final Rule's cross-border approach to the group A, group B, and group C requirements will promote the financial integrity of the markets by fostering transparency and confidence in the significant participants in the U.S. swap markets.

(iii) Price Discovery

The Commission recognizes that the Final 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 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 will be mitigated as jurisdictions harmonize their swap regimes 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 the Final Rule's approach to the group A, group B, and group C requirements will have a noticeable effect on price discovery.

(iv) Sound Risk Management Practices

The Commission believes that the Final 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 in the Final Rule, and is located in a jurisdiction that does not have comparable swap requirements, the Final Rule could lead to weaker risk management practices for such entities.

(v) Other Public Interest Considerations

The Commission believes that the Final Rule is consistent with principles of international comity. The Commission has carefully considered, among other things, the level of foreign jurisdictions' supervisory interests over the subject activity and the extent to which the activity takes place within a particular 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 the Dodd-Frank Act 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 Final Rule appropriately accounts for these competing interests, ensuring that the Commission can discharge its responsibilities to protect the U.S. markets, market participants, and financial system, consistent with international comity. Of particular relevance is the Commission's approach to substituted compliance in the Final Rule, which mitigates burdens associated with potentially duplicative foreign laws and regulations in light of the supervisory interests of foreign regulators in entities domiciled and operating in their own jurisdictions.

D. Antitrust Laws

Section 15(b) of the CEA 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.[569]

The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition. The Commission requested and did not receive any comments on whether the Proposed Rule implicated any other specific public interest to be protected by the antitrust laws.

The Commission has considered the Final Rule to determine whether it is anticompetitive and has identified no significant discretionary anticompetitive effects.[570] The Commission requested and did not receive any comments on whether the Proposed Rule was anticompetitive and, if it was, what the anticompetitive effects are.

Because the Commission has determined that the Final Rule is not anticompetitive and has no significant discretionary anticompetitive effects and received

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[569] 7 U.S.C. 19(b).

[570] The Final Rule is being adopted pursuant to the direction of Congress in section 2(i) of the CEA, as discussed in section I.D, that the swap provisions of the CEA enacted by Title VII of the Dodd-Frank Act, including any rule prescribed or regulation promulgated under the CEA, 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 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. As discussed above, the degree of any competitive disparity will depend on the degree of disparity between the Commission's requirements and that of the relevant foreign jurisdiction.

no comments on its determination on the Proposed Rule, the Commission has not identified any less anticompetitive means of achieving the purposes of the CEA.

XI. 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 Final 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] Does 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, unless the guarantor is a non-financial entity, or unless the Guaranteed Entity is itself below the de minimis threshold and is affiliated with a registered SD.

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

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

Counterparty → / Potential MSP ↓		U.S. Person	Non-U.S. Person: Guaranteed Entity	Non-U.S. Person: SRS	Non-U.S. Person: 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] Does 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[571] should be read in conjunction with the text of the Final Rule.

Counterparty → / Swap Entity ↓		U.S. Person		Non-U.S. Person			
		Non-Foreign Branch	Foreign Branch	U.S. Branch	Guaranteed Entity	Swap Entity SRS	Other Non-U.S. Person or SRS End User
U.S. Swap Entity	Non-Foreign Branch	Yes	Yes	Yes	Yes	Yes	Yes
	Foreign Branch	Yes[1]	Yes[1] *Sub. Comp. Available*	Yes[1]	Yes[1] *Sub. Comp. Available*	Yes[1] *Sub. Comp. Available*	Yes[1, 2] *Sub. Comp. Available*
Non-U.S. Swap Entity	U.S. Branch	Yes	Yes	Yes	Yes	Yes *Sub. Comp. Available*	Yes *Sub. Comp. Available*
	Guaranteed Entity or SRS	Yes[1]	Yes[1] *Sub. Comp. Available*	Yes[1]	Yes[1] *Sub. Comp. Available*	Yes[1] *Sub. Comp. Available*	Yes[1, 3] *Sub. Comp. Available*
	Other Non-U.S. Person	Yes[1]	Yes[1] *Sub. Comp. Available*	Yes[1]	Yes[1] *Sub. Comp. Available*	Yes[1] *Sub. Comp. Available*	No

[1] The Exchange-Traded Exception is available from certain group B and C requirements for certain anonymous, exchange-traded, and cleared foreign-based swaps between the listed parties.
[2] The Limited Foreign Branch Group B Exception is available from the group B requirements for a foreign branch's foreign-based swaps with a foreign counterparty that is an SRS End User or an Other Non-U.S. Person that is not a swap entity, subject to certain conditions.
[3] The Limited Swap Entity SRS/Guaranteed Entity Group B Exception is available from the group B requirements for the foreign-based swaps of each SRS Swap Entity or Guaranteed Swap Entity with a foreign counterparty that is an SRS End User or an Other Non-U.S. Person that is not a swap entity, subject to certain conditions.

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[571] As discussed in section VI.A.2, *supra*, 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. Exceptions from the group B requirements are discussed in sections VI.B.2, VI.B.4, and VI.B.5, *supra*. Substituted compliance for the group B requirements is discussed in section VI.C, *supra*.

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

Table D[572] should be read in conjunction with the text of the Final Rule.

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

[1]The Exchange-Traded Exception is 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 in 17 CFR Part 23

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

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572 As discussed in section VI.A.3, *supra*, the group C requirements are set forth in §§ 23.400 through 23.451 and 23.700 through 23.704 and relate to certain business conduct standards governing the conduct of SDs and MSPs in dealing with their swap counterparties, and the segregation of assets held as collateral in certain uncleared swaps. Exceptions from the group C requirements are discussed in sections VI.B.2 and VI.B.3, *supra*.

For the reasons stated in the preamble, the Commodity Futures Trading Commission amends 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.* Solely for purposes of this section the terms listed in this paragraph (a) have the meanings set forth in paragraphs (a)(1) through (24) of this section. 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 listed in paragraphs (a)(1) through (24) of this section, 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) An *affiliate of*, or a *person affiliated with a specific person,* means 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.

(2) *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.

(3) *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.

(4) *Foreign-based swap* means:

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

(ii) A swap conducted through a foreign branch.

(5) *Foreign counterparty* means:

(i) A non-U.S. person, except with respect to a swap booked in 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.

(6) *Group A requirements* mean the requirements set forth in § 3.3 of this chapter, §§ 23.201, 23.203, 23.600, 23.601, 23.602, 23.603, 23.605, 23.606, 23.607, 23.609 and, to the extent it duplicates § 23.201, § 45.2(a) of this chapter.

(7) *Group B requirements* mean the requirements set forth in §§ 23.202 and 23.501 through 23.504.

(8) *Group C requirements* mean the requirements set forth in §§ 23.400 through 23.451 and 23.700 through 23.704.

(9) *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. Notwithstanding the foregoing, until December 31, 2027, a person may continue to classify counterparties based on:

(i) Representations that were made pursuant to the "guarantee" definition in § 23.160(a)(2) prior to the effective date of this section; or

(ii) Representations made pursuant to the interpretation of the term "guarantee" in the Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 FR 45292 (Jul. 26, 2013), prior to the effective date of this section.

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

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

(12) *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.

(13) *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 an intermediate 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 that the Commission has found comparable pursuant to a published comparability determination with respect to uncleared swap margin requirements.

(14) *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.

(15) *Subsidiary* means an affiliate of a person controlled by such person directly, or indirectly through one or more intermediaries.

(16) *Swap booked in a U.S. branch* means a swap entered into by a U.S. branch where the swap is reflected in the local accounts of the U.S. branch.

(17) *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.

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

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

(20) *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.

(21) *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.

(22) *U.S. GAAP* means U.S. generally accepted accounting principles.

(23) *U.S. person*:

(i) Except as provided in paragraph (a)(23)(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, and their agencies and pension plans.

(iv) Notwithstanding paragraph (a)(23)(i) of this section, until December 31, 2027, a person may continue to classify counterparties as U.S. persons based on:

(A) Representations made pursuant to the "U.S. person" definition in § 23.160(a)(10) prior to the effective date of this section; or

(B) Representations made pursuant to the interpretation of the term "U.S. person" in the Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 FR 45292 (Jul. 26, 2013), prior to the effective date of this section.

(24) *U.S. swap entity* means a swap entity that is a U.S. person.

(b) *Cross-border application of swap dealer 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 (d) of this section and 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; or

(C) The counterparty is itself below the swap dealer de minimis threshold under paragraph (4)(i) of the swap dealer definition in § 1.3, and is affiliated with a registered swap dealer.

(c) *Cross-border application of major swap participant tests.* 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 (subject to paragraph (d) of this section and the major swap participant definition in § 1.3 of this chapter):

(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) *Exception from counting for certain exchange-traded and cleared swaps*. 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 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) introductory text and (a)(1)) and the group C requirements with respect to any swap—

(A) 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;

(B) 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

(C) 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) A non-U.S. swap entity shall be excepted from the group C requirements with respect to any swap booked in a U.S. branch with a foreign counterparty that is neither a foreign branch 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 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—

(i) A significant risk subsidiary that is a swap entity nor

(ii) A person whose performance under the swap is subject to a guarantee by a U.S. person.

(4) 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 swap entity nor a person whose performance under the swap is subject to a guarantee by a U.S. person, subject to the following conditions:

(i) A group B requirement is not eligible for the exception if the requirement, as applicable to the swap, is eligible for substituted compliance 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 does not exceed five percent (5%) of the aggregate gross notional amount of all its swaps.

(5) With respect to its foreign-based swaps, each non-U.S. swap entity that is a significant risk subsidiary (an “SRS SE”) or a person whose performance under the swap is subject to a guarantee by a U.S. person (a “Guaranteed SE”) 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 swap entity nor a person whose performance under the swap is subject to a guarantee by a U.S. person, subject to the following conditions:

(i) A group B requirement is not eligible for the exception if the requirement, as applicable to the swap, is eligible for substituted compliance 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 an SRS SE or a Guaranteed SE in reliance on this exception aggregated with the gross notional amount of swaps conducted by all affiliated SRS SEs and Guaranteed SEs in reliance on this exception does not exceed five percent (5%) of the aggregate gross notional amount of all swaps entered into by the SRS SE or Guaranteed SE and all affiliated swap entities.

(f) *Substituted Compliance.* (1) A non-U.S. swap entity may satisfy any applicable group A requirement by complying with the applicable standards of a foreign jurisdiction to the extent permitted by, and subject to any conditions specified in, a comparability determination issued by the Commission under paragraph (g) of this section;

(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 applicable standards of a foreign jurisdiction to the extent permitted by, and subject to any conditions specified in, a comparability determination issued by the Commission under paragraph (g) of this section; and

(3) A non-U.S. swap entity may satisfy any applicable group B requirement for any swap booked in a U.S. branch with a foreign counterparty that is neither a foreign branch nor a person whose performance under the swap is subject to a guarantee by a U.S. person by complying with the applicable standards of a foreign jurisdiction to the extent permitted by, and subject to any conditions specified in, a comparability determination issued by the Commission 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, the elements or goals of the Commission’s corresponding requirements or group of requirements. Such description should identify the specific legal and regulatory provisions that correspond to each element or goal and, if necessary, whether the relevant foreign jurisdiction's standards do not address a particular element or goal;

(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 or group of requirements, or would result in comparable outcomes as the Commission's corresponding requirements or group of 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, scope of application, effective and compliance dates*—(1) *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.

(2) *Scope of Application.* The requirements of this section shall not apply to swaps executed prior to [INSERT DATE 365 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

(3) *Effective date and compliance date.* (i) This section shall be effective on the date that is 60 days following its publication in the *Federal Register*.

(ii) Provided that swap dealers and major swap participants comply with the recordkeeping requirements in paragraph (h)(1) of this section, the exceptions in paragraph (e) of this section are effective upon the effective date of the rule.

(iii) Swap dealers and major swap participants must comply with the requirements of this section no later than [INSERT DATE 365 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

Issued in Washington, DC, on July 24, 2020, by the Commission.

Christopher Kirkpatrick,

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, Chairman's Statement, 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 P. Tarbert

President John Adams once warned: "Great is the guilt of unnecessary war."[1] While he was obviously referring to military conflicts, his admonition applies to conflicts among nations more generally. Financial regulation has not been exempt from international discord. And in recent years, the CFTC's own cross-border guidance on swaps has caused concerns about a regulatory arms race and the balkanization of global financial markets. Consider the following entreaties by our overseas allies and regulatory counterparts:

[1] Letter from John Adams to Abigail Adams, 19 May 1794 [electronic edition]. *Adams Family Papers: An Electronic Archive,* Massachusetts Historical Society, http://www.masshist.org/digitaladams/.

"At a time of highly fragile economic growth, we believe that it is critical to avoid taking steps that risk withdrawal from global financial markets into inevitably less efficient regional or national markets."

– Letter from the Finance Ministers of the United Kingdom, France, Japan, and the European Commission to CFTC Chairman regarding the CFTC's cross-border guidance (Oct. 17, 2012)

"We believe a failure to address [our] concerns could have unintended consequences, including increasing market fragmentation and, potentially, systemic risk in these markets, as well as unduly increasing the compliance burden on industry and regulators."

– Letter from the Australian Securities and Investments Commission, the Hong Kong Monetary Authority, the Monetary Authority of Singapore, the Reserve Bank of Australia, and the Securities and Futures Commission of Hong Kong to CFTC Chairman regarding the CFTC's cross-border guidance (Aug. 27, 2012)

"… [U]sing personnel or agents located in the U.S. would not be a sufficient criterion supporting the duplication of applicable sets of rules to transactions [between non-U.S. persons,] and [we] ask you to consider not directly applying rules on this basis."

– Letter from Steven Maijoor, Chair, European Securities and Markets Authority to Acting CFTC Chairman regarding the CFTC staff's "ANE Advisory," No. 13-69 (Mar. 13, 2014)

I will leave it to others to debate whether the international discord caused by the CFTC's cross-border guidance[2] and related staff advisory[3] was "necessary" at the time it was introduced. Far more constructive is for us to ask whether it is necessary today. For

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[2] Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 FR 45292 (July 26, 2013) ("2013 Guidance"), http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2013-17958a.pdf.

[3] CFTC Staff Advisory No. 13-69 (Nov. 14, 2013), https://www.cftc.gov/node/212831.

me, there is but one conclusion: Because nearly all G20 jurisdictions have adopted similar swaps regulations pursuant to the Pittsburgh Accords,[4] it is unnecessary for the CFTC to be the world's policeman for all swaps.

On this basis, I am pleased to support the Commission's final rule on the cross-border application of registration thresholds and certain requirements for swap dealers and major swap participants ("swap entities"). This final rule provides critically needed regulatory certainty to the global swaps markets. And I believe it properly balances protection of our national interests with appropriate deference to international counterparts.

Need for Rule-Based Finality

As noted above, the Commission's 2013 Guidance left much to be desired by both our market participants and our regulatory colleagues overseas. The action was taken outside the standard rulemaking process under the Administrative Procedure Act,[5] so was merely "guidance" that is not technically enforceable. But because market participants as a practical matter followed it nonetheless, it had a sweeping impact on the global swaps markets. 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 sought to address.

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[4] Financial Stability Board, *Annual Report on Implementation and Effects of the G20 Financial Regulatory Reforms* 3 (Oct. 16, 2019) (showing that a very large majority of FSB jurisdictions have implemented the G20 priority reforms for over-the-counter derivatives).

[5] 5 U.S.C. 551 *et seq.*

Congressional Mandate

We call this final rule a "cross-border" rule, and in certain respects it is. For example, the 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 rule answers a basic question: *What swap dealing activity outside the United States should trigger CFTC registration and other requirements?*

To answer this question, we must turn to section 2(i) of the Commodity Exchange Act ("CEA"),[6] a provision Congress added in Title VII of the Dodd-Frank Act. 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 they run afoul of the Commission's rules or regulations that prevent evasion of Title VII. 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 final rule we issue today is a levelheaded approach to the exterritorial application of our swap dealer registration regime and related requirements, and it fully implements 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 parts of the global swaps markets. In short, the final rule employs neither a

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[6] 7 U.S.C. 2(i).

full-throated "intergalactic commerce clause"[7] nor an isolationist mentality. It is thoughtful and balanced, and it will avoid future unnecessary conflicts among regulators.

Guiding Principles for Regulating Foreign Activities

As I have stated before,[8] I am guided by three additional principles in considering the extent to which the CFTC should make use of our 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 regard, Congress provided the CFTC with explicit extraterritorial power to safeguard the U.S. financial system where swaps activities are concerned.

It is incumbent upon us to guard against risks created outside the United States flowing back into our country. But our focus cannot be on *all* risks. Congress made that clear in section 2(i). It would be a markedly poor use of American taxpayers' dollars to regulate swaps activities in far-flung lands simply to prevent every risk that might have a nexus to the United States. It would also divert the CFTC from channeling our resources where they matter the most: to our own markets and participants. The rule therefore focuses on instances where 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.

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[7] 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), 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").

[8] Statement of Chairman Heath P. Tarbert in Support of the Cross-Border Swaps Proposal (Dec. 18, 2019), https://www.cftc.gov/PressRoom/SpeechesTestimony/tarbertstatement121819.

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"). As explained in the rule, 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. Our final cross-border rule requires 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.[9]

2. Follow Kant's Categorical Imperative

As I said when we proposed this rule, I believe cross-border rulemaking should follow Kant's "categorical imperative": we should act according to the maxim that we wish all other rational people to follow, as if it were a universal law.[10]

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[9] The SRS concept is 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 U.S. regulation. 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), http://www.gpo.gov/fdsys/pkg/CPRT–111JPRT56698/pdf/CPRT–111JPRT56698.pdf. If the Commission did not regulate SRSs, 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.

[10] "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.).

What I take from that is that we should ourselves establish a regulatory regime that we believe should be the global convention. How would this work? Let me start by explaining how it would not work. If we impose our regulations on non-U.S. 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 markets—itself a potential source of systemic risk.[11] 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 markets.

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. parent companies 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.[12] By the same token, when U.S. subsidiaries of foreign

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[11] *See* Financial Stability Board, *Annual Report on Implementation and Effects of the G20 Financial Regulatory Reforms* 3 (Oct. 16, 2019).

[12] *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), 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."); FSB Fragmentation Report, *supra* note 11, at 8 (noting that the G20 "has agreed that jurisdictions and regulators should be able to defer to each other when it is justified

companies operate within our borders, we expect them to follow our laws and regulations and not simply comply with rules from their home country.

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 defer to our domestic counterparts on questions of dealing activity outside the United States. The Federal Reserve Board has extensive regulatory and supervisory tools to ensure a holding company is prudent in its risk-taking at home and abroad.[13] The CFTC instead should focus on regulating dealing activity within the United States or with U.S. persons.

3. Pursue SEC Harmonization Where Appropriate

As I said in connection with our proposal of this rule, I find it surreal that the SEC and the CFTC, 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 unnecessarily increased operational and compliance costs for market

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by the quality of their respective regulatory and enforcement regimes, based on similar outcomes in a non-discriminatory way, paying due respect to home country regulation regimes").

[13] 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.").

participants.[14] I am pleased that this final rule uses the same definition of "U.S. person" as 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.[15] We should do so 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. We must also consider whether differences in our respective products or markets warrant a divergent approach. Just as today's final rule takes steps toward harmonization, it also diverges where appropriate.

The approach we have taken with respect to "ANE Transactions" is deliberately different than the SEC's.[16] 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.

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[14] *See, e.g.,* Futures Industry Association Letter re: Harmonization of SEC and CFTC Regulatory Frameworks (Nov. 29, 2018), https://fia.org/articles/fia-offers-recommendations-cftc-and-sec-harmonization.

[15] *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), 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.").

[16] *See* Securities and Exchange Commission, Final Rules and Guidance on Cross-Border Application of Certain Security-Based Swap Requirements, 85 FR 6270, 6272 (Feb. 4, 2020) (stating that "the [SEC] continues to believe the 'arranged, negotiated, or executed' criteria form an appropriate basis for applying Title VII requirements in the cross-border context").

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. 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 single-name credit default swaps, where the arranging, negotiating, or execution is typically done in the United States because the underlying reference entity is a U.S. company. More generally, security-based swaps can affect the price and liquidity of the underlying security, so the SEC has a legitimate interest in regulating transactions in those instruments. By contrast, because commodities are traded globally, there is less need for the CFTC to apply its swaps rules to ANE Transactions.[17]

Moreover, 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, the SEC has not crafted its cross-border rule to extend to an SRS engaged in security-based swap dealing activity offshore that may pose a systemic risk to our financial system. Our rule does with respect to swaps, aiming to protect American taxpayers from another

[17] Under the final rule, persons engaging in any aspect of swap transactions within the United States remain subject to the CEA provisions 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.

Enron conducting its swaps activities through a major foreign subsidiary without CFTC oversight.

The final rule addresses Transaction-Level Requirements applicable to swap entities (specifically, the Group B and Group C requirements), but does not cover other Transaction-Level Requirements, such as the reporting, clearing, and trade execution requirements. The Commission intends to address these remaining Transaction-Level Requirements (the "Unaddressed TLRs") in connection with future cross-border rulemakings. Until such time, the Commission will not consider, as a matter of policy, a non-U.S. swap entity's use of their personnel or agents located in the United States to "arrange, negotiate, or execute" swap transactions with non-U.S. counterparties for purposes of determining whether Unaddressed TLRs apply to such transactions.

In connection with the final rule, DSIO has withdrawn Staff Advisory No. 13-69,[18] and, together with the Division of Clearing and Risk and the Division of Market Oversight, granted certain non-U.S. swap dealers no-action relief with respect to the applicability of the Unaddressed TLRs to their transactions with non-U.S. counterparties that are arranged, negotiated, or executed in the United States. In Staff Advisory 13-69, the CFTC's staff applied Transaction-Level Requirements to ANE Transactions, without the Commission engaging in notice and comment rulemaking to determine whether such an application is appropriate. Going forward, I fully expect that the Commission will first conduct fact-finding to determine the extent to which ANE Transactions raise policy concerns that are not otherwise addressed by the CEA or our regulations.

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[18] CFTC Staff Advisory No. 13-69 (Nov. 14, 2013), https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/13-69.pdf.

Refinements to the Proposed Rule

In response to public comment, and consistent with the guiding principles described above, the final rule includes a number of refinements from the proposal issued last December. I will leave it to our extremely knowledgeable staff to outline all the changes in detail, but I will highlight some of the key refinements here. These principally concern the treatment of SRSs and U.S. branches of foreign swap entities.

1. Significant Risk Subsidiaries

As noted, the SRS concept is not intended to reach subsidiaries of holding companies that are subject to consolidated supervision by the Federal Reserve Board. The final rule recognizes that intermediate holding companies of foreign banking organizations under the Federal Reserve Board's Regulation YY are subject to such consolidated supervision, and to enhanced capital, liquidity, risk-management, and stress-testing requirements. Accordingly, foreign subsidiaries of intermediate holding companies are excluded from the SRS definition under the final rule.

In addition, the final rule recognizes that certain SRSs may act as "customers" or "end users" in the global swaps markets, engaging in only a *de minimis* level of swap dealing or no dealing activity at all. Consistent with the principle of focusing on risk to the United States, the "Group B" category of risk-mitigating regulatory requirements will not apply to swaps between a non-U.S. swap entity and an SRS that is simply an end user.[19] This approach will help preserve end users' access to liquidity in foreign markets.

[19] This exception applies only to "Other Non-U.S. Person" swap entities, i.e., non-U.S. swap entities that are neither an SRS nor an entity subject to a U.S. person guarantee ("guaranteed entity"). A non-U.S. swap entity that is an SRS or guaranteed entity would need to rely on the limited Group B exception discussed below.

For similar reasons, the final rule also provides a limited exception from the Group B requirements for a swap entity that is an SRS or a guaranteed entity—to the extent that swap entity's counterparty is an SRS end user or an Other Non-U.S. Person that is not a swap entity. In addition, the final rule clarifies that a non-U.S. person that is not itself an SRS or a guaranteed entity need not count swaps with an SRS toward its swap dealer *de minimis* threshold, unless that SRS is a guaranteed entity.

I believe these adjustments to the proposed SRS regime will further serve to channel our regulatory resources, while offering appropriate deference to our domestic and foreign regulatory counterparts.

2. U.S. Branches

The final rule also includes two key changes to the treatment of U.S. branches of foreign swap entities. First, it expands the availability of substituted compliance for the Group B requirements to include swaps between such a U.S. branch, on the one hand, and an SRS or Other Non-U.S. Person, on the other.[20] And second, it creates a new exception from the "Group C" external business conduct standards for swaps between U.S. branches and foreign counterparties (other than guaranteed entities and foreign branches of U.S. swap entities). These changes recognize that U.S. branches, though located on U.S. soil, are part of a non-U.S. legal entity. Accordingly, while such branches should be subject to certain risk-mitigating regulations, they should not be subject to the full panoply of requirements applicable to true U.S. persons.

[20] This expansion of substituted compliance does not apply to swaps between two U.S. branches of non-U.S. swap entities.

Conclusion

In sum, the final rule before us today provides a critical measure of regulatory certainty for the global swaps markets. I believe the rule is also a sensible and principled approach to addressing when foreign transactions should fall within the CFTC's swap entity registration and related requirements.

I have noted before President Eisenhower's observation that "The world must learn to work together, or finally it will not work at all." I sincerely hope our domestic and international counterparts will view today's action as a positive step toward further cooperation to provide sound regulation to the global swaps markets.

Appendix 3 – Supporting Statement of Commissioner Brian Quintenz

I am very pleased to support today's final rule interpreting Congress' statutory directive that the Commission may only regulate those foreign activities that "have a direct and significant connection with activities in, or effect on commerce, of the United States."[1] As I noted when I supported the proposal last December, 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.[2] Today's rule provides important safeguards to the US financial markets in delineating which cross-border swap activity must be counted towards potential registration with the Commission, and which transactions should be subject to the CFTC's business conduct requirements for swap dealers (SDs) and major swap participants (MSPs). At the same time, the final

[1] Sec. 2(i) of the Commodity Exchange Act.

[2] Supporting Statement of Commissioner Brian Quintenz Regarding Proposed Rule: Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to SDs and MSPs, https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement121819b.

rule appropriately defers to foreign regulatory regimes to avoid duplicative regulation and disadvantaging U.S. institutions acting in foreign markets.

Today's rule achieves the goals for cross-border regulation that I articulated in a speech before the ISDA Annual Japan Conference in October of last year.[3] I stated that each jurisdiction's recognition of, and deference to, the sovereignty of other jurisdictions is crucial in avoiding market fragmentation that poses serious risks to the liquidity and health of the derivatives markets. This rule properly grants deference to other jurisdictions by limiting the extent to which non-US counterparties must comply with significant aspects of the CFTC's regulatory framework for SDs and MSPs and by providing market participants with the opportunity to comply with local laws that the Commission has deemed comparable to the CFTC's regulations ("substituted compliance").

Substituted Compliance

As I noted with respect to the proposal, substituted compliance is the lynchpin of a global swaps market, and the absence of regulatory deference has been the fracturing sound we hear when the global swaps market fragments. The final rule provides a framework for substituted compliance with respect to two sets of regulations, "group A" entity-level requirements, such as conflicts of interest policies and a risk management program, and "group B" transaction-level requirements, such as daily trading records, confirmation, and portfolio reconciliation. While the Commission has issued substituted compliance determinations for entity-level requirements in six jurisdictions and for

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[3] Remarks of CFTC Commissioner Brian Quintenz at 2019 ISDA Annual Japan Conference, "Significant's Significance,"
https://www.cftc.gov/PressRoom/SpeechesTestimony/opaquintenz20.

transaction-level requirements in two jurisdictions, they all contain exceptions for particular provisions of the Commission's regulations, and one of the transaction-level determinations partially addresses only two of the five regulations in group B.[4]

Today's rule provides for a flexible, outcomes-based framework for future comparability determinations that will assess the goals of the Commission's regulations against the standards of its foreign counterparts' regimes, instead of directing the Commission to focus on a rigid line-by-line or even regulation-by-regulation comparison.[5] More specifically, and a primary reason for my support of this final rule, under this new framework, the Commission can compare the goals of its regulations to the outcomes of foreign regulations on an entire group-wide basis, so that the standards of a foreign regime will be considered holistically compared to the goals of all the Commission's either group A or group B requirements.

Additionally, this final rule allows the Commission to proactively assess and issue comparability determinations without waiting for a request from a jurisdiction. I recognize that several G-20 jurisdictions have made significant progress in the area of issuing transaction-level requirements, as evidenced by a recent report by the Financial Stability Board (FSB).[6] I hope that the Commission will soon issue additional substituted compliance determinations in order that foreign firms registered as SDs with the Commission, as well as foreign branches of US SDs, can gain the efficiencies of

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[4] The determinations are available at,
https://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/index.htm.
The transaction-level determination partially addressing only two of the group B regulations is for Japan, 78 FR 78890 (Dec. 27, 2013).

[5] Regulation 23.23(g).

[6] FSB, OTC Derivatives Market Reforms: 2019 Progress Report on Implementation (Oct. 15, 2019), Table M,
https://www.fsb.org/wp-content/uploads/P151019.pdf.

complying with local laws for many of their transactions with non-US persons.[7] Ideally, future determinations will provide for comprehensive, holistic substituted compliance in a particular jurisdiction for all transaction-level requirements in the CFTC's group B.

ANE

Today's rule properly eliminates the possibility that a non-US SD be required to follow many of the CFTC's transaction-level requirements for a swap opposite a non-US counterparty if US-based personnel of that SD "arrange, negotiate, or execute" (ANE) the swap. This action brings to a close almost seven years of uncertainty, beginning with the misguided DSIO Advisory of November 2013.[8] I note that the staff's no-action letter issued this week suspends enforcement of ANE with respect to transaction-level requirements not covered by today's rule, specifically in the areas of real-time reporting of swaps to data repositories and the clearing and trade execution requirements, pending future Commission rulemakings that address these rules in a cross-border context. I expect the Commission will issue such rules in the near future in order to provide the marketplace with legal certainty in these areas and formally dispense with the ANE construct, just as it has with respect to the requirements addressed today. I believe strongly that ANE has no place with respect to real-time reporting, the clearing requirement, or the trade execution requirement, just like it has no place with respect to the business conduct regulations.

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[7] The availability of substituted compliance, depending on the status of the counterparty, is provided for in regulation 23.23(f)(1) with respect to group A regulations and in 23.23(f)(2) through (3) with respect to group B regulations.

[8] CFTC Staff Advisory 13-69 (Nov. 14, 2013).

US Guarantees and SRS

Another important element of today's rule is that it only requires two, clearly defined classes of non-US entities to count all of their swaps towards the Commission's SD and MSP registration thresholds, and to generally comply with the Commission's SD and MSP rules if registered. The first is an entity whose obligations to a swap are guaranteed by a US person, under a standard consistent with the Commission's cross-border rule for uncleared swap margin requirements.[9] The second is an entity deemed a "significant risk subsidiary" (SRS) of a US firm. It is very important that subsidiaries of US bank holding companies, including intermediate subsidiaries, are carved out from the SRS definition. Those firms are subject to supervision by the Federal Reserve Board, and, therefore, it does not make sense for the CFTC to deploy its precious resources to regulating those entities.

Helping US SDs' Foreign Branches Compete

Today's rule properly makes substituted compliance available for group B requirements to a foreign branch of a US SD similarly to how substituted compliance is available for many non-US SDs registered with the Commission. I expect that this will help these branches compete with local institutions in that they will be subject to the same rules. For example, the Commission has already granted substituted compliance to EU regulations with respect to certain group B regulations.[10] As a result, both the EU branch of a US firm registered with the Commission as an SD and an EU firm registered as an SD could comply with many of the same EU rules for swaps with a US person or

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[9] Regulation 23.160.

[10] 78 FR 78878 (Dec. 27, 2013).

with a non-US person that is either US-guaranteed or an SRS registered as an SD or MSP ("swap entity SRS"). Moreover, under the "limited foreign branch group B exception," the foreign branch of a US firm would be excused from complying with any group B rules, subject to a 5% notional cap, for a swap with a non-US person that is neither US guaranteed nor a swap entity SRS. However, if substituted compliance has been provided in a jurisdiction, then instead of being excused from the group B rules for those swaps, the foreign branch would have to comply with the local rules. Due to the fact that neither of the transaction-level determinations granted comparability for all of the group B requirements, with respect to those requirements not subject to a substituted compliance determination, the foreign branch may either comply with CFTC regulations or count the notional value of the swap towards its 5% limited group B exception. Clearly, the rules favor the possibility of substituted compliance, pursuant to which a foreign branch of a US firm would have no limitation in following local rules. I believe that group-wide comparability determinations, without any exceptions, would simplify this situation and make more consistent the treatment of US dealer's foreign branches and their local competitors.

In conclusion, I am very pleased to have been a part of the Commission that accomplished this major milestone in a long road of issuing final regulations in the area of cross-border swaps oversight. I would like to thank the staff of the Division of Swap Dealer and Intermediary Oversight for all of their work in completing this final rule and to Chairman Tarbert for his leadership on this important issue.

Appendix 4 – Dissenting Statement of Commissioner Rostin Behnam

Introduction and Overview

Today, by approving a final rule addressing the cross-border application of the registration thresholds and certain requirements applicable to swap dealers ("SDs") and major swap participants ("MSPs") (the "Final Rule"), the Commodity Futures Trading Commission ("CFTC" or "Commission") overlooks Dodd-Frank Act[1] purposes, Congressional mandates thereunder, an opinion of the D.C. District Court,[2] and multiple comments raising significant concerns. The Commission instead relies on broad deference that opens a gaping hole[3] in the federal regulatory structure. I cannot support a decision to jettison a cross-border regime that has not proven unreasonable, inflexible, or ineffective in favor of an approach that fails to address the most critical concerns that the Dodd-Frank Act directed the CFTC to address in favor of "*more workable*"[4] solutions. As the Final Rule opts to address the conflicts of economic interest between the regulated and those who are advantaged by it[5] by usurping Congressional (and congressionally delegated) authority to rethink section 2(i) of the Commodity Exchange Act ("CEA" or "Act") via prescriptive rules, I must respectfully dissent.

Almost ten years ago to the day, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act as a legislative response to the 2008 financial crisis. Driven by a series of systemic failures, the crisis laid bare that the essentially

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[1] The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank Act").

[2] *SIFMA v. CFTC*, 67 F.Supp.3d 373 (D.D.C. 2014).

[3] *See generally Gonzales v. Raich*, 545 U.S. 1 (2005) (relied on by the Commission in the Final Rule at 1.D.2.(i) and in the Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swaps Regulations, 78 FR 45292, 45300 (Jul. 26, 2013) ("Guidance") to support its interpretation of 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.).

[4] *See, e.g.,* Final Rule at II.C.3.

[5] *See Wickard v. Filburn*, 317 U.S. 111, 129 (1942).

unregulated and unmonitored over-the-counter derivatives or "swaps" markets were not the bastions of efficiency, stability, and resiliency they were thought to be.[6] Title VII of the Dodd-Frank Act gave the Commission new and broad authority to regulate the swaps market to address and mitigate risks arising from swap activities.[7]

Although much of the over-the-counter derivatives market's contributions to the 2008 financial crisis completed their journey within the continental U.S., the risk originated in foreign jurisdictions.[8] Accordingly, Congress provided in CEA section 2(i) that the provisions of Title VII, as well as any rules or regulations issued by the CFTC, apply to cross-border activities when certain conditions are met.[9]

The D.C. District Court recognized that "Section 2(i) operates independently, without the need for implementing regulations, and that the CFTC is well within its discretion to proceed by case-by-case adjudications, rather than rulemaking, when applying Section 2(i)'s jurisdictional nexus."[10] The D.C. District Court also found that, because the Commission was "not required to issue *any* rules (let alone binding rules) regarding its intended enforcement policies pursuant to Section 2(i)," the CFTC's decision to issue the Guidance as a non-binding policy statement benefits market participants.[11] To the extent the CFTC interpreted the meaning of CEA section 2(i) in its

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[6] *See SIFMA*, 67 F.Supp.3d at 385-86 (citing *Inv. Co. Inst. v. CFTC*, 891 F.Supp.2d 162, 171, 173 (D.D.C. 2012), *aff'd*, 720 F.3d 370 (D.C. Cir. 2013)).

[7] *See* Guidance, 78 FR at 45299.

[8] *See* Guidance, 78 FR at 45293-45295; *see also SIFMA*, 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).

[9] 7 U.S.C. 2(i).

[10] *SIFMA* , 67 F.Supp.3d at 423-25, 427; ("Although many provisions in the Dodd-Frank Act explicitly require implementing regulations, Section 2(i) does not.").

[11] *Id.* at 423 (citation omitted).

2013 cross-border Guidance, an interpretation carried forward in the Final Rule today (and in its proposal), such interpretation is permissibly drawn linguistically from the statute and, regardless, cannot substantively change the legislative reach of section 2(i) or the Title VII regime.[12] In this regard, the interpretation reinforces the direct meaning of CEA section (2)(i)'s grant of authority—without implementing regulations—to enforce the Title VII rules extraterritorially whenever activities "have a direct and significant connection with activities in, or effect on, commerce of the United States."[13] Putting aside the anti-evasion prong in CEA section 2(i)(2), it remains that CEA section 2(i) applies the swaps provisions of the CEA to certain activities, viewed in the class or aggregate, outside the United States, that meet either of two jurisdictional nexuses: (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]

The Dodd-Frank Act's derivatives reforms contemplate that an individual entity's systemic riskiness is a product of the interrelations among its various activities and risk-management practices. As a result, the post-crisis reforms target the activity of derivatives trading as a means to reach those entities that conduct the trading.[15] As the

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[12] *Id.* at 424.

[13] *Id.* at 426.

[14] *See* Proposal at C.1.; Guidance, 78 FR at 45292, 45300; *see also SIFMA*, 67 F.Supp.3d at 424-25, 428 n. 31 (finding that Congress addressed issue of determining which entities and activities are covered by Title VII regulations, "For Congress already addressed this 'important' issue by defining the scope of the Title VII Rules' extraterritorial applications in the statute itself.").

[15] *See* Jeremy Kress et al., Regulating Entities and Activities: Complimentary Approaches to Nonbank Systemic Risk, 92 S. CAL. L. REV. 1455, 1459-60, 1462 (Sept. 2019).

Commission has acknowledged, "Neither the statutory definition of 'swap dealer' nor the Commission's further definition of that term turns solely on risk to the U.S. financial system."[16] 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."[17] By adopting an overarching risk-based approach to cross-border regulation today, the Commission jeopardizes the integrity and soundness of the markets it regulates. The Final Rule acknowledges that systemic risk may derive from the activities of entities that do not individually generate the kind of risk that would subject them to systemic risk-based regulation, but then chooses not to address that very risk. When the CFTC focuses its regulatory oversight only on individually systemically significant entities, it unavoidably leaves risky activities unregulated that due to the interconnectedness of global markets individually, and in the aggregate, can and likely will negatively impact U.S. markets.[18]

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[16] 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"); *see also* Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 FR 30596, 30597-98 (May 23, 2012) ("SD Definition Adopting Release") (explaining how the Dodd-Frank Act definitions of "swap dealer" and "security-based swap dealer" focus on whether a person engages in particular types of activities involving swaps or security based swaps); *id.* at 30757 (In response to questions as to whether the swap dealer definition should appropriately be activities-based or relate to how an entity is classified, Chairman Gensler clarified that, "The final rule is consistent with Congressional intent that we take an activities-based approach.").

[17] 2016 Proposal, 81 FR at 71952.

[18] *See* Guidance, 78 FR at 45300 (consistent with relevant case law and the purpose of Title VII to protect the U.S. financial system from the build-up of systemic risks, under CEA section 2(i), the Commission must assess the connection of swap activities, viewed as a class or in the aggregate, to activities in commerce of the United States to determine whether application of the CEA swaps provisions is warranted).

Moreover, Congress embedded a risk-based approach, appropriate to the Commission's mandate, within the Dodd-Frank Act's swap dealer definition by instructing the Commission to exempt from designation as a dealer a person that "engages in a *de minimis* quantity of swap dealing in connection with transactions with or on behalf of its customers" and providing that an insured depository institution is not to be considered a swap dealer ''to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer.''[19] The swap dealer definition further provides that a person may be designated as a dealer for one or more types, classes or categories of swaps or activities without being designated a dealer for other types, classes, or categories of swaps or activities,[20] further indicating that the type and level of risk a particular person's activities present are the guiding factor in determining whether they may be required to register with the Commission as an SD and comply with the requirements of Title VII. The Commission seems to have lost sight of the fact that the activity of swap dealing itself presents the type of risk addressed by Title VII.[21] The Commission's ability to establish a threshold amount of such activity that warrants direct oversight via registration does not diminish this underlying trait, which is not binary, but a measure of the scale of risk. Risk is simply in the DNA of an SD.

As recognized by the Commission, requiring registration and compliance with the requirements of the Dodd-Frank Act reduces risk and enhances operational standards and

[19] *See* CEA section 1a(49)(C) through (D), 7 U.S.C. 1a(49)(C) through (D).

[20] *See* CEA section 1a(49)(B), 7 U.S.C. 1a(49)(B).

[21] *See* Final Rule at II.D.3.(iv) (identifying the SD *de minimis* threshold as "a strictly activity-based test (*i.e.*, a test based on the aggregate gross notional amount of dealing activity).

fair dealing in the swaps markets.[22] To the extent the Dodd-Frank Act was enacted to reduce systemic risk to the financial system, the CFTC's role is to individually utilize its expertise in addressing risk to the financial system created by interconnections in the swaps market as a market conduct regulator through supervisory oversight of SDs and MSPs,[23] and to contribute as a voting member in support of the broader systemic risk oversight carried out by the Financial Stability Oversight Council ("FSOC").[24]

Since 2013, when the Commission announced its first cross-border approach in flexible guidance as a non-binding policy statement,[25] the Commission has understood that the global scale of the swap markets and domestic scale of regulation poses significant challenges for regulators and market participants.[26] I dissented from the December 2019 proposal for the Final Rule the Commission considers today.[27] Like the Final Rule, the Proposal suggested that we can resolve all complexities in one fell swoop

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[22] *See* SD Definition Adopting Release, 77 FR at 30599.

[23] *See* Press Release Number 8033-19, CFTC, CFTC Orders Six Financial Institutions to Pay Total of More Than $6 Million for Reporting Failures (Oct. 1, 2019), https://www.cftc.gov/PressRoom/PressReleases/8033-19 ("The Commission's swap-dealer risk management rules are designed to monitor and regulate the systemic risk endemic to the swaps marke.t"); *see also,* Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 84 FR 71740, 71744 (Dec. 30, 2019) (explaining that the activities-based approach to identifying, assessing, and addressing potential risks and threats to U.S. financial stability reflects two priorities, one of which is "allowing relevant financial regulatory agencies, which generally possess greater information and expertise with respect to company, product, and market risks, to address potential risks, rather than subjecting companies to new regulatory authorities.").

[24] Among other things, the FSOC is authorized to "issue recommendations to the primary financial regulatory agencies to apply new or heightened standards and safeguards." Dodd-Frank Act section 120, 124 Stat. at 1408-1410.

[25] *See* Guidance, 78 FR at 45292.

[26] *See* Hannah L. Buxbaum, *Transnational Legal Ordering and Regulatory Conflict: Lessons from the Regulation of Cross Border Derivatives*, 1 U.C. IRVINE J. INT'L TRANSNAT'L & COMP. L. 91, 92 (2016).

[27] *See* Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 FR 952, 1008 (proposed Jan. 8, 2020) (the "Proposal").

if we alter our lens, abandon our longstanding and literal interpretation of CEA section 2(i), and limit ourselves to the purely *risk-based approach* described therein.

Today's action ignores that, "It is the essence of regulation that it lays a restraining hand on the self-interest of the regulated and that the advantages from the regulation commonly fall to others."[28] The Final Rule is essentially the Proposal with a more clearly articulated intention to rethink the Commission's mandate under the Dodd-Frank Act to seize the status of primary significant risk regulator—a position the Commission was neither delegated to assume nor provided the resources to occupy—so as to limit the application of Title VII. Like the Proposal, the Final Rule acknowledges the likelihood that the chosen course will result in increased risks of the kind Title VII directs us to address flowing into the U.S., or even originating in the U.S. via ANE activities, and then states a belief that the chosen approach is either "adequate"[29] or of no moment because our focus on significant participants in the U.S. market should ensure the appropriate persons are subject to Commission oversight via registration, even if, "to the extent that a registered SD or MSP relies on the exceptions in the Final Rule, and is located in a jurisdiction that does not have comparable swap requirements, the Final Rule could lead to weaker risk management practices for such entities.".[30] This approach boils down to: ad hoc harmonizing with the Securities and Exchange Commission ("SEC"); de facto delegating to the U.S. prudential regulators; or deferring to a foreign jurisdiction under a banner of comity without ever explaining how the application of the swap dealer *de minimis* registration threshold is unreasonable.

[28] *Wickard v. Filburn*, 317 U.S. 111.

[29] *See, e.g.*, Final Rule at II.D.3.(iii)-(iv).

[30] Final Rule at X.C.11.(iv).

In various statements throughout the preamble, the Commission subtly—and not so subtly—promotes its emergent "desire to focus its authority on potential significant risks to the U.S. financial system."[31] In one glaring instance, the Commission responds to a very clear comment on the weakness of the SRS definition in terms of addressing evasion and avoidance concerns by eviscerating Congress's very carefully crafted SD definition, stating, "[w]ithout this risk-based approach [SRS], the SD de minimis threshold, which is a strictly activity-based test (*i.e.*, a test based on the aggregate gross notional amount of dealing activity), becomes the de facto risk test of when an entity would be subject to the Commission's swap requirements as an SD."[32] In the past several years, I have noted the Commission's eagerness to bypass clear Congressional intent in order to address longstanding concerns with Dodd-Frank Act implementation.[33] Indeed, the Commission has at times made a concerted effort to avoid targeted amendments in favor of sweeping changes to the regulation of swap dealers without regard for the long term consequences of its fickle interpretation of the law and analysis of risk.[34] I have grave concerns that the Final Rule's motive in commandeering the role of systemic risk regulator is to provide certainty to entities that they will have sufficient paths in the future to avoid registration with the Commission, and thus fly under the radar of the FSOC and the entire Title VII regime. As the D.C. District Court noted, the Commission cannot

[31] *See* Final Rule at V.C.

[32] *See* Final Rule at II.D.3.(iv).

[33] *See, e.g.,* De Minimis Exception to the Swap Dealer Definition—Swaps Entered into by Insured Depository Institutions in Connection With Loans to Customers, 84 FR 12450, 12468-12471 (Apr. 1, 2019).

[34] *See, e.g., id.*; Segregation of Assets Held as Collateral in Uncleared Swap Transactions, 84 FR 12894, 12906 (Apr. 3, 2019); De Minimis Exception to the Swap Dealer Definition, 83 FR 27444 (proposed June 12, 2018).

second-guess Congress' decision that Title VII apply extraterritorially.[35] In layering its new approach over the CEA section 2(i) analysis, the Commission does just that.

My dissent to the Proposal expounded at length on concerns with the Commission's "new approach," which seeks to improve upon and clarify the Guidance while reallocating responsibilities in a manner that is ill-conceived given that we are just 10 years past one crisis, and currently navigating a global pandemic. Accordingly, I will not reiterate my earlier points, but incorporate by reference my prior dissent,[36] which is still on point save for a comment I made on the "unlimited U.S. responsibility prong" to the U.S. person definition, which has been addressed, and I thank staff for addressing my concern.[37] I will, however, take the opportunity here to focus on how the Commission's approach to the cross-border application of the SD registration threshold in the Final Rule amounts to a re-write of the Dodd-Frank Act, as exemplified by the "significant risk subsidiary" or "SRS" definition.

The Commission Does Not Have a Blank Check

By codifying a purely and defined risk-based approach to its extraterritorial jurisdiction, exempting from the CFTC's regulatory oversight all entities but those which individually pose systemic risk to the U.S. financial system, the CFTC abdicates its Congressionally-mandated responsibility under CEA section 2(i) to regulate activities outside of the United States that meet one of the aforementioned jurisdictional nexuses.[38] The Final Rule today defies Congress' clear intent in enacting CEA section 2(i),

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[35] *SIFMA* , 67 F.Supp.3d at 432.

[36] *See* 85 FR at 1009-1013.

[37] *Id.* at 1011.

[38] *See* 7 U.S.C. 2(i).

improperly elevates comity over adhesion to the CFTC's mandate, and increases the riskiness of global swap markets.

Congress demonstrated its ability to discern between purely systemic risk-based and activities-based regulation when it designated authority to the CFTC. It directed the Commission to develop a metric to analyze which entities pose enough risk to require SD registration, creating an exception to the registration requirement for entities engaged in only a *de minimis* quantity of swap dealing.[39] It is telling that the CEA does not, under section 2(i), direct the CFTC to develop a similar threshold measurement to evaluate whether foreign entities singularly pose systemic risk to U.S. commerce. The lack of a comparable exception in CEA section 2(i) indicates that Congress intended to do exactly what the plain language of CEA section 2(i) suggests—require that the CFTC oversee *activities* outside of the U.S. that pose risk to U.S. commerce (not individual persons or entities).[40] Furthermore, nothing in the swap dealer definition or CEA section 2(i) expresses that we should defer to prudential regulators, whether U.S. or foreign; prudentially-regulated entities may be required to register as swap dealers with the CFTC.[41] If the Congress believed that prudential regulation could sufficiently mitigate risk to the U.S. financial system, it would have chosen to delegate this function to the U.S. prudential regulators. Congress instead chose to enact a registration requirement in Title VII of the Dodd-Frank Act. Ultimately, the introduction of the concept of an "SRS"

[39] *See* CEA section 1a(49)(D); 7 U.S.C. 1a(49)(D).

[40] *Silvers v. Sony Pictures Entm't, Inc.*, 402 F.3d 881, 885 (9th Cir. 2005) ("The doctrine of expressio unius est exclusio alterius 'as applied to statutory interpretation creates a presumption that when a statute designates certain persons, things, or manners of operation, all omissions should be understood as exclusions.'" (quoting *Boudette v. Barnette*, 923 F.2d 754, 756-57 (9th Cir. 1991)).

[41] *See also* CEA section 4s(c), 7 U.S.C. 4s(c) (requiring any person that is required to register as a swap dealer or major swap participant to register with the Commission, "regardless of whether the person also is a depository institution or is registered with the Securities and Exchange Commission.").

and accompanying exemptions for: (1) entities with parents that have less than $50 billion in consolidated assets, and for entities that are already (2) prudentially regulated or (3) subject to comparable foreign regulation, is impermissible under CEA section 2(i).

Whether or not we agree with Congress, the CFTC is not free to rewrite the statute and enact rules that contravene our mandate. Agencies may not act like they have a "blank check" to proffer legislative rules outside of their delegated authority;[42] regulators have to take directives from their governing statute and not second-guess Congress.[43] Thus, the CFTC is not free to disregard its mandate in the pursuit of other objectives—such as comity, deference, adequacy, workability, or an inexplicable desire to act solely like a prudential regulator—no matter how laudable some of those objectives might be.[44] The Commission today dodges the responsibility with which it was entrusted in the wake of a crisis, impermissibly rewriting the Dodd-Frank Act to pass the buck to prudential regulators and our international counterparts.

The CFTC's implementation of the Final Rule's purely risk-based approach to regulating global swaps is neither allowable under Title VII, nor is it wise. Our current Chairman, in fulfilling his role as the CFTC's representative on the FSOC, when

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[42] Neomi Rao, Address at the Brookings Institution: What's next for Trump's regulatory agenda: A conversation with OIRA Administrator Neomi Rao (Jan. 26, 2018), Transcript at 10 ("…agencies should not act as though they have a blank check from Congress to make law."), https://www.brookings.edu/wp-content/uploads/2018/01/es_20180126_oira_transcript.pdf.

[43] *See SIFMA*, 67 F.Supp.3d at 432 (finding that the CFTC "could not have second-guessed Congress decision" that Title VII rules apply extraterritorially).

[44] *BP W. Coast Prods., LLC v. FERC*, 374 F.3d 1263 (D.C. Cir. 2004) (Congressional mandates to agencies to carry out "specific statutory directives define[ing] the relevant functions of [the agency] in a particular area." Such a mandate does not create for the agency "a roving commission" to achieve those or "any other laudable goal." (quoting *Michigan v. EPA*, 268 F.3d 1075, 1084 (D.C. Cir. 2001)); *see also Farmers Union Cent. Exch., Inc*. v. *FERC*, 734 F.2d 1486, 1500 (D.C.C. 1984) ("Agency decisionmaking, of course, must be more than 'reasoned' in light of the record. It must also be true to the Congressional mandate from which it derives authority.").

supporting guidance signifying that the FSOC would adopt an activities-based approach to determining risks to financial stability, stated that an entity-based approach, "inevitably leads to a 'whack-a-mole' scenario in which risky activities are transferred out of highly-regulated entities and into less-regulated ones."[45] Given the conglomeration of exceptions built into the Final Rule's definitions of "guarantee," and "SRS," and its determination regarding "ANE Transactions," it is hard to see how this transfer of risk to less-regulated entities—which still pose risk in the aggregate to U.S. markets—will not come to pass, inevitably leaving gaps in the CFTC's ability to oversee the activities it regulates.

With respect to our cooperation with foreign counterparts, I firmly believe that the CFTC should work diligently to coordinate oversight and elevate principles of international comity as we develop our cross-border approach—but not when doing so requires us to abdicate our mandate. To that end, I generally support the Final Rule's application of substituted compliance even if I do not fully agree with entity categorizations via the definitions. I also generally support the CFTC's deference to foreign regulators when it makes sound comparability determinations. To the extent the Final Rule grants somewhat indeterminate discretion to the CFTC to depart from an objective evaluation in making such determinations, as noted by several commenters,[46] I will remain vigilant when participating in such Commission action and be mindful of potential for slippage.

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[45] Heath P. Tarbert, Chairman, CFTC, Statement on the New Activities-Based Approach to Systemic Risk (Dec. 19, 2019), https://www.cftc.gov/PressRoom/SpeechesTestimony/tarbertstatement120619.

[46] *See* Proposal at VI.D.1.(ii.).

I remain concerned that the Final Rule, like the Proposal, makes vague references to "comity" to justify our resistance to regulating overseas activities that pose risk to U.S. markets. I agree that making substituted compliance available to foreign entities or subsidiaries, via sound comparability determinations, is appropriately deferential to principles of international comity. Nevertheless, we should only use comity to justify rulemaking when there is ambiguity in the governing statute,[47] or when our requirements unreasonably interfere with those of our international counterparts[48]—neither of which is overtly true regarding our statutory obligation under CEA sections 4s(a) and (c)[49] to register SDs and MSPs based on their swap activities. Registration is a critical first step in determining whether a non-U.S. entity is engaged in activities covered under 2(i), and must not be disregarded for the sake of comity.

It is also pertinent to note here that by prioritizing comity and refusing to appropriately retain jurisdiction, at least to some degree, over transactions that are arranged, negotiated, or executed in the United States by non-U.S. SDs with non-U.S. counterparties ("ANE Transactions"), the Commission's abdication of Congressionally-mandated responsibility extends beyond CEA section 2(i). There is no need to even

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[47] Michael Greenberger, *Too Big to Fail—U.S. Banks' Regulatory Alchemy: Converting an Obscure Agency Footnote into an "At Will" Nullification of Dodd-Frank's Regulation of the Multi-Trillion Dollar Financial Swaps Market*, 14 J. BUS. & TECH. L. 197, 367 (2019) ("There is no legal precedent extant that defines 'international comity' as giving authority to a U.S. administrative agency to weaken unilaterally the otherwise clear Congressional statutory language or intent that the statute must be applied extraterritorially.")

[48] *See* Proposal, 85 FR at 957; Final Rule at II.D.3.(iv); Aaron D. Simowitz, *The Extraterritoriality Formalisms,* 51 CONN. L. REV. 375, 405-6 and n. 205 (2019) (describing the principle of "prescriptive comity" in the Restatement (Fourth) of Foreign Relations Law and recognizing that "Interference with the sovereign authority of foreign states may be reasonable if such application would serve the legitimate interests of the United States." (citing Restatement (Fourth) of Foreign Relations Law § 405 cmt. (AM. LAW. INST. 2018)).

[49] CEA section 4s(a), (c), 7 U.S.C. 4s(a), (c).

address whether these transactions have a “direct and substantial” impact on U.S. commerce, because they occur *in* the United States and accordingly fall squarely within the regulatory purview of the CFTC.[50] Ignoring all ANE Transactions invites entities to evade U.S. law, even as they avail themselves of the benefits of U.S. markets by residing in the U.S. and using U.S. personnel, as they can administratively treat transactions as booked in a foreign subsidiary based on the conclusion that any relevant risk has been shipped off. I am concerned that the CFTC is improperly fixating on comity at the expense of not only its mandate, but also at the expense of developing sound regulation that increases transparency, competition, and market integrity. The Final Rule brushes past concerns raised by a market participant that exempting ANE transactions from reporting requirements gives non-U.S. entities an advantage over U.S. SDs and jeopardizes the intended benefits of the CFTC’s public reporting regime.[51] I am concerned by the Commission’s response to the comment,[52] and I struggle to understand why any U.S. regulator would implement a rule that defies its statutory mandate, subjects U.S. entities to a competitive disadvantage relative to its foreign counterparts, and reduces U.S. investors’ transparency into the markets.

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[50] *See SIFMA,* 67 F. Supp. 3d at 426 (”Section 2(i)'s "technical language initially lays down a general rule placing all [swap] activity" occurring outside of the United States beyond Title VII's reach. But it then expressly brings such swap activities "back within" Title VII's purview). ANE Transactions should not be a part of the initial exemption step required by section 2(i), because they do not occur outside of the United States.

[51] *See* Proposal at V. B.-C.; Citadel, Comment Letter on Proposed Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants (Mar. 9, 2020), https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=62376.

[52] *See SIFMA,* 67 F. Supp. 3d at 429 (An agency “‘need not address every comment, but it must respond in a reasoned manner to those that raise significant problems.’”(citing *Covad Commc’ns Co. v. FCC,* 450 F.3d 528, 550 (D.C. Cir. 2006) (quoting *Reytblatt v. Nuclear Regulatory Comm’n,* 105 F.3d 715, 722 (D.C. Cir. 1997))).

SRS: This Is the Way

In my dissent to the Proposal, I identified SRS as the most elaborate departure from both the Commission's interpretation of CEA section 2(i) and from our mandate under the Dodd-Frank Act, in its elimination of a large cross-section of non-U.S. subsidiaries of U.S. parent entities from having to count their swap dealing activities toward the relevant SD or MSP registration threshold calculations.[53] The SRS replaces the conduit affiliate concept from the Guidance, which, although broader, served to (1) appropriately define the universe of entities whose risks related to swap activities may accrue and have a direct and significant connection with activities in, or effect on, U.S. commerce, and (2) harmonize with the SEC's cross-border application of the *de minimis* threshold relevant to security-based swap dealing activity.[54]

Despite a clear split among Commissioners and commenters, the Commission has determined to move forward with the SRS, which creates broad exceptions that could exclude large amounts of the swap dealing activities by foreign subsidiaries of U.S. entities from counting towards the SD and MSP registration threshold calculations and therefore, ultimately exclude them from the Commission's oversight and application of the swap dealer regulations. In support of its determination, the Commission rehashes and repeats the argument that SRS "embodies" the Commission's purely risk-based approach.[55] If "this is the way,"[56] then I am afraid our new approach may not account--

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[53] 85 FR at 1012; *see also* Dissenting Statement of Commissioner Dan M. Berkovitz, 85 FR at 1015 (describing the SRS construct as "an empty set.").

[54] *See* 17 CFR 240.3a71-3(a)(1).

[55] See Final Rule at II.C. 3.(iii) (in declining to incorporate risk transfer and risk acceptance test into the "significant subsidiary" definition, the Commission finds that such activity-based tests are inconsistent with the Commission's determination to apply swap requirements to foreign entities using a risk-based test to

perhaps at all--for the risk that Congress and the Dodd-Frank Act directed the Commission to oversee. If Congress had wanted the Commission to focus its cross-border authority solely on systemically significant non-bank entities, it would have been explicit, and refrained from using language in CEA section 2(i) that was so embedded in common law.[57]

In excluding subsidiaries of bank holding companies and intermediate holding companies from the SRS definition, the Commission defers to the "role of prudential regulation in the consolidated oversight of prudential risk," again relying on "the risk-based approach to determining which foreign subsidiaries present a significant risk to their ultimate U.S. parent and thus to the financial system."[58] In presuming that prudential oversight provides "sufficient" comparable oversight to that prescribed by Title VII, the Commission entirely ignores that history weighs against such a presumption[59] and Congress acted accordingly.[60] Under the Dodd-Frank Act, the CFTC

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isolate entities that the Commission considers to pose a significant risk to the financial system based solely on their significance in terms of their balance sheet size relative to the parent entity).

[56]"This is the way" is identified as a Mandalorian mantra and cultural meme associated with keeping members of the group on the same wavelength without any question at all. *See* Evan Romano, *What 'This Is the Way' Explains About the Mandalorians in The Mandalorian,* MEN'SHEALTH (Nov. 22, 2019).

[57] *See, e.g.* Proposal at I.C.1.; Guidance 81 FR at 45298-45300; s*ee SIFMA,* 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.").

[58] Notably, the Commission determined to use the $50 billion threshold for the ultimate parent entity of an SRS because the FSOC initially used a $50 billion total consolidated assets quantitative test as one threshold to apply to nonbank financial entities for purposes of designated nonbank financial companies as "systemically important financial institutions" ("SIFIs"). *See* Proposal, 85 FR at 965 n.134. The FSOC recently voted to remove the $50 billion threshold because, among other things, it was "not compatible with the prioritization of an activities-based approach" to addressing risks to financial stability. *Id.;* see also FSOC Interpretive Guidance, 84 FR at 71742.

[59] *See, e.g.,* Guidance, 78 FR at 45294; Proposal, 85 FR at 1013-1015.

[60] *Id.*

is the "primary financial regulatory agency" for swap dealers.[61] CEA section 4s(c)[62] provides that any person that is required to be registered as an SD or MSP shall register with the CFTC regardless of whether the person also is a depository institution (i.e., any bank or savings association) or is registered with the SEC as a security-based swap dealer. Moreover, to the extent SDs or MSPs have a prudential regulator, Title VII recognizes that such SDs/MSPs are to comply with capital and margin requirements established by their respective prudential regulators.[63] However, it explicitly does not recognize prudential regulation as a substitute for SD/MSP regulatory oversight by the Commission.[64]

Again, I believe that our cross-border approach must absolutely align with principles of international comity and that our rules and supervisory approach should harmonize and work in tandem with prudential regulation. However, I do not believe that the SRS definition is reasonable or consistent with the SD definition or CEA section 2(i), due to its deference to the role of prudential regulation in the consolidated oversight of prudential risk to carve out consideration of swap dealing activities of non-U.S. entities (that are not guaranteed by a U.S. person) for purposes of SD registration and Commission oversight.

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[61] Dodd-Frank Act, Pub. L. 111-203 section 2(12)(C)(viii), 124 Stat. 1389.

[62] CEA section 4s(c), 7 U.S.C. 4s(c).

[63] CEA section 4s(e)(2)(A), 7 U.S.C. 4s(e)(2)(A)

[64] *See* Eig, *supra* note 57 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))).

The Final Rule would suggest that our consideration of the activities of non-U.S. subsidiaries of U.S. entities is an "expansion" of the Commission's oversight.[65] I disagree. The post-2010 crisis reforms require intensive oversight of entities engaged in swaps activities throughout the world. The Commission must retain in full its oversight and regulatory responsibilities over entities whose activities have a direct and significant connection with activities in, or effect on, U.S. commerce. To do that effectively, we must be able to apply the SD definition and *de minimis* threshold to the web of interconnections through which risk travels, not simply rely on bright line balance sheet box checking to wholesale elimination of non-U.S. subsidiaries from our scope of consideration. As I stated in my prior dissent, without a more concrete understanding as to whether SRS is truly superior to the conduit affiliate[66] concept currently outlined in the Guidance and presumably similar to the SEC's own approach, it is difficult to get behind a policy that would bring risk into the U.S. of the very type CEA Section 2(i) seeks to address.

Complexity and Burden Should Not Direct the Outcomes

I continue to have reservations regarding the Commission's determination to discard the Guidance and the use of agency guidance and non-binding policy statements in favor of prescriptive rules.[67] As I noted with regard to the Proposal, while the Guidance is complex, it is no more complex than this Final Rule. Complexity is the hallmark of the regulation of cross-border derivatives, and "merely reflects the

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[65] Final Rule at II. D. 3. (iv).

[66] *See*, *e.g.*, 85 FR at 1012 (noting the Proposal's lack of explaining whether and how the conduit affiliate concept failed to achieve its purpose, is no longer relevant, resulted in loss of liquidity or market fragmentation, proved unworkable, etc.).

[67] *Id.* at 1010.

complexity of swaps markets, swaps transactions, and the corporate structures of the market participants that the CFTC regulates."[68] I am especially concerned that the Commission is acting in haste to nail down hard and fast rules while many pieces in the global regulatory puzzle are still in flux.

Commenters refrained from weighing in on the virtues of retaining the Guidance—or agency guidance generally. The Proposal garnered just 18 relevant comment letters.[69] It is difficult to determine why, but perhaps market participants have followed the Guidance and utilized their expertise in reviewing the overall statutory scheme and the straightforward language of CEA section 2(i) to come into compliance with Title VII either directly or via substituted compliance and have not found it prohibitive to do so.[70]

Like the Proposal, the Final Rule prides its alteration of various definitions such as "U.S. person" and "guarantee," the substitution of SRS for conduit affiliates, and the abandonment of ANE Transactions, as burden and/or cost reducing (or, "more workable"). Unfortunately, I believe the Commission in some instances has not fully evaluated the true weight of the burdens, and in other instances, not fully measured those

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[68] *SIFMA,* 67 F.Supp.3d 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 (1947))).

[69] Comments to the Proposal are available at https://comments.cftc.gov/PublicComments/CommentList.aspx?id=3067. Of note, the proposal to the Guidance received approximately 290 comment letters. Guidance, 78 FR at 45295. The 2016 Proposal received approximately 29 substantive comment letters, available at https://comments.cftc.gov/PublicComments/CommentList.aspx?id=1752.

[70] Indeed, the D.C. District Court concluded that the CFTC need not address every facet of the overall regulatory scheme and can rely on regulated market participants to reference other controlling statutes and regulations to address issues left unresolved by a given Title VII rule. *See SIFMA,* 67 F. Supp. 3d at 428 n.31.

burdens against the goals of Title VII and the benefits of the overall intent of CEA section 2(i).

A straightforward example is the Commission's determination to increase the proposed five-year time limits for reliance on representations regarding U.S. person and guarantee status to seven years to appease commenters who asked for perpetual reliance on previously obtained representations.[71] There is no indication that the Commission considered anything but providing market participants more time, in spite of recognizing that best practice would be to obtain updated representations as soon as practicable.

A more concerning example is the Commission's decision to move forward with a narrower definition of "guarantee" than that outlined in the Guidance, despite recognizing that it could lead to entities counting fewer swaps towards their *de minimis* registration threshold or "qualify additional counterparties for exceptions to certain regulatory requirements as compared to the definition in the Guidance."[72] The Commission did not address the commenter who also pointed out that the narrower definition would allow significant risk to be transferred back to the U.S. financial system over time noting that, "economic implications are just as important as legal considerations, as confirmed and intended by CEA section 2(i)(1).[73] Instead, the Final Rule offers the possibility that the SRS definition would capture some non-U.S. persons, returning to the mantra that in this way we focus on those entities that represent "material risk to the U.S. financial system," through something "workable."[74]

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[71] *See* Final Rule at II.B.5. and C.3.

[72] *See* Final Rule at II.C.2. and 3.

[73] *Id.*

[74] *See* Final Rule at II.C.3.

Conclusion

Before I conclude, I would like to take a moment to thank staff from the Division of Swap Dealer and Intermediary Oversight for their presentations, tireless work on this rulemaking, and frequent engagement with my office over the last few weeks leading up to today's open meeting. Like all of the CFTC's work, today's discussion would not have been possible without the expertise and commitment of our dedicated staff.

As the Commission wraps up its scheduled work, before a brief summer respite, particularly on this 10th anniversary week of the Dodd-Frank Act, our work yesterday and today, although some may like to think it, is *not* the culmination of years of work towards implementing the Dodd-Frank Act. In fact, the Commission acted promptly in issuing the cross-border 2013 Guidance, only a few years after bill passage and in the throes of dozens of other equally important Title VII rulemakings.

This week's exercise is a retrenchment of sound derivatives policy that provided the CFTC the tools necessary to monitor swap markets and protect the U.S. financial system and American taxpayers, and most importantly was steadfast to clearly articulated Congressional intent. There is always room for improvement, tweaking, and evolving—I have said as much, many times since becoming a Commissioner.

But, unfortunately, during this week that we should be lifting up the merits of financial reform, especially given the role post-crisis reforms played in absorbing massive shocks during the worst of the Covid-19 pandemic just a few months ago, we are turning back the clock to a previous era that proved to be inadequate to meeting our core responsibilities.

Appendix 5 – Statement of Commissioner Dawn D. Stump

Overview

When we met together in person late last year to consider proposing cross-border rules with respect to registration thresholds and regulatory requirements applicable to swap dealers and major swap participants (the "Proposal"),[1] I stressed that because we were proposing to replace the Commission's 2013 cross-border guidance (the "Guidance")[2] with binding and enforceable rules, those rules must be clear, sensible, and workable.[3] In supporting the Proposal at the time, I concluded that the proposed rules met those standards. And I have not seen anything in the many thoughtful comment letters we received that causes me to doubt that conclusion.

The final rules that are before us today, as we meet remotely several months later, are largely the same as those we proposed. But based on public input: 1) in several places, we are providing clarifications requested by market participants;[4] 2) in a few places where the proposal deviated from the Guidance, we have been persuaded that the Guidance got it right, and thus are returning to the Guidance approach;[5] and 3) in still

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[1] There are no registered major swap participants at this time. Accordingly, for convenience, this Statement generally will refer only to swap dealers, and not to major swap participants.

[2] Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 FR 45292 (July 26, 2013).

[3] Statement of Commissioner Dawn D. Stump Regarding Proposed Rule: Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants (December 18, 2019), available at https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement121819.

[4] *E.g.,* clarification that in addition to entities that are subject to capital regulation by the CFTC, Securities and Exchange Commission ("SEC"), or US prudential regulators, the attribution requirement in connection with the major swap participant registration threshold also excludes entities subject to Basel-compliant capital standards and oversight by a G-20 prudential supervisor.

[5] *E.g.,* addition of a provision that was in the Guidance, but not in the Proposal, whereby a non-US person does not have to count in its *de minimis* swap dealer registration calculation swaps entered into with an entity whose swap obligations are guaranteed by a US person if the guaranteed entity is itself below the *de minimis* threshold and is affiliated with a registered swap dealer.

other places, we are incorporating suggestions made by commenters.[6] As a result, the final rules build and improve upon the foundation laid by the Proposal. They, too, are clear, sensible, and workable, and I am pleased to support them.

I do not plan to summarize here the changes to the Proposal that are encompassed within the final rules. To those not steeped in the minutiae of *de minimis* swap dealer registration calculations and entity- and transaction-level requirements under the Guidance,[7] such a summary can become somewhat mind-numbing. Instead, I would like to place today's cross-border rulemaking in context, and explain my support from a broader perspective.

Section 2(i) and Codifying the Guidance

We begin, as we must, with the terms of the statute – Section 2(i) of the Commodity Exchange Act ("CEA"), which was added by the Dodd-Frank Act.[8] Given the importance of this topic, please indulge my reiterating a few points that I made about the Proposal.

Section 2(i) limits the international reach of CFTC swap regulations by affirmatively stating that they "shall not apply to activities outside the United States unless those activities . . . have a direct and significant connection with activities in, or

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[6] *E.g.:* 1) while the Proposal removed the prong of the "U.S. person" definition in the Guidance that included a legal entity that is majority-owned by one or more US person(s) in which such person(s) "bears unlimited responsibility for the obligations and liabilities" of the legal entity, the final rules add such a circumstance to the definition of a "guarantee;" and 2) while the Proposal excepted certain subsidiaries of bank holding companies from the definition of a "significant risk subsidiary," the final rules also except certain subsidiaries of intermediate holding companies in the same circumstances.

[7] The final rules replace the Guidance's classification of requirements imposed on registered swap dealers under the Commission's rules as entity- and transaction-level requirements with a similar (but not identical) classification into group A, group B, and group C requirements (discussed further below).

[8] Public Law 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank").

effect on, commerce of the United States."[9] A common-sense reading of this section is that there is a limited extraterritorial reach to the Dodd-Frank swap requirements, and to stretch them beyond the stated statutory criteria impermissibly infringes upon the rule sets of other nations.

That is, the plainly stated congressional intent is to start with US law not applying beyond our borders, and then continue to the limited conditions where extraterritoriality would be deemed appropriate. The law does not say that CFTC rules govern derivatives market activities around the world if there is *any* linkage or tie to the United States and should not be interpreted and abused as such.

In adopting rules setting out how we will apply Section 2(i) to the registration thresholds and regulatory requirements relevant to the cross-border activities of swap dealers, we are not writing on a blank canvas. The Guidance has been in place for seven years now, and although it is non-binding,[10] market participants (both those that have registered and those that have had to determine whether they are required to register) have devoted a tremendous amount of human and financial resources to conform to its complicated contours.

Faced with that reality, although I was not a fan of the Guidance when it was issued,[11] I agree that it is appropriate to codify its basic elements into our rule set rather than start from scratch. And that is what the final rules before us today will do. The final

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[9] CEA Section 2(i), 7 U.S.C. 2(i).

[10] *SIFMA v. CFTC,* 67 F. Supp.3d 373 (D.D.C. 2014).

[11] When the CFTC was considering the Guidance, I shared the view vividly articulated by then-Commissioner Jill Sommers that the Guidance, as it had been proposed, reflected "what could only be called the 'Intergalactic Commerce Clause' of the United States Constitution . . ." *See* Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 Fed. Reg. 41214, 41239 (proposed July 12, 2012) (Statement of Commissioner Sommers).

rules codify many elements of the Guidance, while updating a few provisions to reflect current realities and incorporating some improvements based on our experience during the intervening years.[12]

Much has been made of statements in the Proposal, which are carried over into today's release, that the focus of the Commission's analysis under Section 2(i) is on risk to the U.S. financial system. But this, too, is essentially a codification of the approach taken in the Guidance. While I do not often quote then-Chairman Gary Gensler, I note that in his Statement supporting the adoption of the Guidance, he said:

> There's no question to me, at least, that the words of Dodd-Frank addressed this (i.e., risk importation) when they said that a direct and significant connection with activities and/or effect on commerce in the United States covers these risks that may come back to us.
>
> I want to publicly thank Chairman Barney Frank along with Spencer Bachus, Frank Lucas, and Collin Peterson, and their staffs for reaching out to the CFTC and the public to ask how to best address offshore risks that could wash back to our economy in Dodd- Frank.[13]

Implementing our statutory cross-border mandate through a risk-based analysis that focuses on the pertinent issue of risk to the US financial system is a sensible approach, which I endorse.

For those who maintain that the final rules take too narrow a view of the Commission's extraterritorial reach with respect to swap dealers, I note the truly remarkable fact that today, with the Guidance in effect, approximately half of the over

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[12] Several commenters asked the Commission to take the opportunity of this rulemaking to significantly alter the Guidance approach to the cross-border activities of swap dealers in various respects. As noted, we have determined to codify, rather than reconstruct, most of the decisions that underlie the Guidance (although we have made some adjustments as discussed herein). While maintaining the *status quo* under the Guidance may deny affected market participants results they wish for, it does not require them to give up what they have had for the past seven years.

[13] Guidance, 78 FR at 45371 (Statement of Chairman Gary Gensler).

100 swap dealers currently registered with the CFTC are located outside the United States.[14] This percentage has stayed relatively constant since the CFTC's swap dealer registration regime "went live" at the end of 2012. Registered non-US swap dealers are located across the globe – in North and South America, Europe, Asia, and Australia.

In other words, although it is non-binding, the Commission's Guidance appears to have brought a substantial portion of global swap dealing activity into the Commission's swap dealer regulatory regime. And the record before us is devoid of evidence suggesting that the number of registered non-US swap dealers is seriously over- or under-inclusive. Given the extent to which the final rules codify the Guidance, a significant change in that number is unlikely.

Because the final rules essentially codify the Guidance, and because I support the final rules for the reasons explained herein, I accept the interpretation of CEA Section 2(i) stated in the Guidance and the final rules in the limited context of registration thresholds and regulatory requirements applicable to swap dealers. To codify the Guidance while revising the foundation on which it was based would only generate confusion – as opposed to the clarity that I hope this rulemaking will bring to one aspect of our cross-border work.

But the analysis of, in Mr. Gensler's words, "offshore risks that could wash back to our economy" may well differ in the context of other Dodd-Frank requirements. As we proceed with other aspects of our cross-border work – in areas such as clearing, trade

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[14] *See* National Futures Association Membership and Directories (data as of July 22, 2020), available at https://www.nfa.futures.org/registration-membership/membership-and-directories.html#SDRegistry.

execution, and reporting – rigorous analysis of the Section 2(i) test for each rule we adopt is necessary to ensure that the law is followed both to the letter and in spirit.

Clear, Sensible, and Workable Rules

Transitioning from the interpretation of Section 2(i) to the rules before us, some have questioned why we are adopting rules in the first place. While it is true that Section 2(i), unlike other provisions in Dodd-Frank, does not require the Commission to adopt implementing rules, I believe it is good government to do so. Guidance has its place, of course. Given the nascent state of post-Pittsburgh derivatives reforms in 2013, reliance on guidance made sense at the time. But I have spoken before of the benefits of codifying interpretations issued by our staff where appropriate,[15] and those benefits accrue in equal measure to the codification of Commission guidance. Replacing the prior Guidance with rules that reflect current realities and are based on experience developed during the past seven years provides certainty to the marketplace and a shared understanding of the "rules of the road."

Some may argue that in those few places where the rules of the road that we are adopting today depart from the Guidance, the Commission has retreated with respect to the extraterritorial application of its swap regulatory regime. As I shall discuss, however, such criticisms fail to take account of other, equally important, considerations relevant to the exercise of our rulemaking authority: 1) the aforementioned need for clear, sensible, and workable rules; and 2) appropriate deference to comparable regimes of our international regulatory colleagues.

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[15] *See* Statement of Commissioner Dawn D. Stump Regarding Amending Rule 3.10(c)(3) – Exemption from Registration for Foreign Persons Acting as Commodity Pool Operators on Behalf of Offshore Commodity Pools (May 28, 2020) ("Commissioner Stump Part 3 Statement"), available at https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement052820.

Definition of a "Guarantee"

For example, the release accompanying the final rules acknowledges that the definition of a "guarantee" that we are adopting today is narrower than that in the Guidance. The final rules define a "guarantee" as an arrangement in which one party to a swap has rights of recourse against a guarantor with respect to its counterparty's obligations under the swap, with "rights of recourse" meaning a legally enforceable right to collect payments from the guarantor. By contrast, the Guidance interpreted a "guarantee" to include not only the foregoing, "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."[16]

The concept of a guarantee is important to our cross-border rules for swap dealers in part because a guarantee of a non-US person's swap obligations by a US person can require the non-US person – or its non-US counterparty – to count the swap towards its *de minimis* swap dealer registration threshold. But when the determination of whether an entity must register with the CFTC depends on whether the entity's or its counterparty's obligations under a swap are guaranteed by a US person, the meaning of the term "guarantee" cannot be left to a review of "all the facts and circumstances."

A rule in which non-US persons must try to determine, or obtain representations from non-US counterparties regarding, whether the CFTC might subsequently conclude that a particular arrangement satisfies an open-ended definition of a "guarantee" is not a workable rule. By contrast, the definition of a "guarantee" in the final rules, which is based on concepts of legal recourse and a legally enforceable right to recover, is clear and

[16] Guidance, 78 FR at 45320 (emphasis added).

workable. Some may downplay the importance of "workability" in Commission rulemakings, but no matter how well-intentioned a rule may be, if it is not workable, it cannot deliver on its intended purpose.

Significant Risk Subsidiaries

Some commenters objected that the definition of a "significant risk subsidiary" inappropriately substitutes oversight by the Board of Governors of the Federal Reserve System (the "FRB"), and/or foreign regulatory authorities, for the Commission's regulation of derivatives market activity overseas. A significant risk subsidiary, or "SRS," is a non-US "significant subsidiary" (based on various numerical metrics set out in the final rules) of an ultimate US parent entity that has more than $50 billion in global consolidated assets. Excluded from the definition, however, are non-US subsidiaries that are subject to either: 1) consolidated supervision and regulation by the FRB as a subsidiary of a US bank holding company ("BHC") or intermediate holding company ("IHC"); or 2) capital standards and oversight by the subsidiary's home country supervisor that are consistent with Basel requirements and subject to margin requirements for uncleared swaps in a jurisdiction for which the Commission has issued a margin comparability determination. It is these exclusions that commenters have cited as a concern.

To this, there are three responses. First, as discussed above, in exercising the Commission's oversight responsibilities with respect to an SRS (which, again, is a non-US subsidiary), we look to the risk that such a subsidiary poses to its ultimate parent in the United States, and thus to the US financial system. It is not that we are replacing our oversight responsibilities with those of the FRB or foreign regulators. Rather, it is that we have determined that the risk presented by foreign subsidiaries consolidated with a BHC or IHC, or subject to regulation as specified in the SRS definition in their home country, is already being adequately monitored and thus does not warrant an additional layer of regulation by the CFTC.

Second, we must compare the SRS definition in the final rules to what it replaces in the Guidance: The "conduit affiliate." The Guidance did not actually define a conduit affiliate, but rather described it in terms of certain "factors." The most critical factor, but unfortunately also the most amorphous, was the last one, which asked whether "the non-U.S. person in the regular course of business, engages in swaps with non-U.S. third-party(ies) for the purpose of hedging or mitigating risks faced by, or to take positions on behalf of, its U.S. affiliate(s), and enters into offsetting swaps or other arrangements with its U.S. affiliate(s) in order to transfer the risks and benefits of such swaps with third-party(ies) to its U.S. affiliates."[17]

As with the definition of a "guarantee," I make no apologies for supporting the workable definition of an SRS in the final rules, which is based on objective and observable metrics, as compared to the ambiguous description of a conduit affiliate set forth in the Guidance. We owe the global swaps market the certainty that can only come from clarity in our rules, and the definition of an SRS in the final rules fits the bill.

Third, the record before us does not afford any basis on which to conclude that the definition of an SRS in the final rules will lead to any less robust Commission oversight of the cross-border swap activities of swap dealers than does the vague description of a conduit affiliate in the Guidance. We have no evidence that the number of non-US

[17] Guidance, 78 FR at 45318 n.258 and 45359.

entities that have waded through the multi-faceted conduit affiliate description in the Guidance and concluded that they were a conduit affiliate, but would conclude that they are not an SRS under the definition in the final rules, is significant – or even material. If experience going forward proves otherwise, the Commission can always amend the SRS definition accordingly. But absent such evidence, hypothetical concerns are an insufficient basis on which to reject the clear and workable SRS definition in the final rules.

ANE Transactions, Exceptions to Regulatory Requirements, and Substituted Compliance

Finally, some may see a retreat from the Guidance in the Commission's determinations: 1) not to apply its group A, group B, or group C requirements[18] to swaps of a non-US swap dealer with a non-US counterparty where the non-US swap dealer uses personnel or agents in the United States to arrange, negotiate, or execute the swaps ("ANE transactions"); 2) to except certain foreign-based swaps from the group B and group C requirements; and 3) to expand the availability of substituted compliance to encompass group B requirements for swaps between a US branch of a non-US swap dealer and certain non-US counterparties. I respectfully disagree.

First, the notion that the CFTC's swap regulatory regime should apply to ANE transactions was not stated in the Commission's Guidance; rather, it was stated in a staff Advisory published after the Guidance was adopted. The Commission has never

[18] Under the final rules: 1) group A requirements for swap dealers generally relate to the Chief Compliance Officer requirement, risk management, swap data recordkeeping, and antitrust considerations; 2) group B requirements for swap dealers generally relate to swap trading relationship documentation, portfolio reconciliation and compression, trade confirmation, and daily trading records; and 3) group C requirements for swap dealers generally relate to external business conduct rules, including voluntary initial margin segregation.

endorsed that staff view, and it has never taken effect.[19] Second, the exceptions from swap dealer requirements that apply to the swaps of non-US swap dealers with non-US persons, again, generally codify exceptions that were included in the Guidance, too.

To be sure, based on input we received in the comments, the final rules include two exceptions to swap dealer regulatory requirements that were not included in the Proposal. Yet, to take one as an example, today's release explains that the "Limited Swap Entity SRS/Guaranteed Entity Group B Exception" is: 1) *tailored* to placing foreign swap dealer subsidiaries of US firms on the same footing as foreign branches of US swap dealers; 2) *consistent* with an exception in the Guidance that was not carried forward in the Proposal;[20] and 3) *limited* in terms of the amount of swaps that can be entered into in reliance on the exception, and unavailable if the parties can rely on substituted compliance instead.

But what is critically important for the treatment of ANE transactions, the exceptions to certain regulatory requirements, and substituted compliance in the final rules is to keep in mind the scenario at issue: Although in some instances activity with respect to the swap may occur in the United States, the swaps involve non-US swap dealers (or foreign branches of US swap dealers) and a non-US counterparty (or a foreign branch of a US person) and, therefore, will also be subject to regulation in another

[19] Today's release acknowledges that the policy the Commission is adopting with respect to the applicability of CFTC requirements to non-US swap dealers' ANE transactions differs from that taken by the SEC. But as has often been said, harmonization with the SEC, while an important goal and one that Congress supported in Dodd-Frank, should not be undertaken simply for harmonization's own sake. Here, the Commission has determined that, in light of Congress' decision to define security-based swaps as "securities" in Dodd-Frank, harmonization with the SEC's determination to apply its existing, pre-Dodd-Frank securities broker-dealer regulation to ANE transactions in security-based swaps is not appropriate.

[20] The release explains that under the Guidance, a non-US person that was guaranteed by a US person or a conduit affiliate would not have been expected to comply with group B requirements when transacting with a non-US counterparty that also was not guaranteed by a US person or a conduit affiliate.

jurisdiction. Where the regulatory interest of that other jurisdiction is paramount, the CFTC should appropriately defer, just as where the Commission's regulatory interest is paramount, we expect other foreign jurisdictions to defer to our regulation. As I stated in connection with a recent Open Meeting that also addressed cross-border issues:

> [T]he Commission's historical commitment to appropriate deference to our international regulatory colleagues (which also is sometimes referred to as mutual recognition), 'is a demonstration of international comity – an expression of mutual respect for the important interests of foreign sovereigns.' This deference also reflects the shared goals of global authorities seeking to achieve the most effectively regulated markets through coordination rather than duplication.[21]

The Commission's historical commitment to mutual recognition is in keeping with principles of international comity. In reviewing the comment letters, frankly, there sometimes seems to be a sense that "international comity" is simply a buzzword the Commission invokes to justify what critics believe is an improper easing of its regulation of cross-border activity. I emphatically reject the notion that appropriate deference to international regulatory authorities weakens oversight or protections of our markets, market participants, or financial system. To the contrary, our reliance on international comity is deeply rooted in several sources.

First, as discussed in greater detail in the release, the Restatement (Fourth) of Foreign Relations Law of the United States counsels 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.[22]

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[21] *See* Commissioner Stump Part 3 Statement, n.15, *supra* (footnote omitted).

[22] Restatement (Fourth) section 405 cmt. A (Westlaw 2018).

This doctrine of reasonableness is "a principle of statutory interpretation"[23] that has been recognized in Supreme Court case law.[24]

Second, Congress in Dodd-Frank specifically directed the Commission, "[i]n order to promote effective and consistent global regulation of swaps," to "consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation . . . of swaps [and] swap entities . . ."[25] Congress recognized that global swap markets cannot function absent consistent international standards.

Third, as I have previously observed on multiple occasions, when the G-20 leaders met in Pittsburgh in the midst of the financial crisis in 2009, they, too, recognized that due to the global nature of the derivatives markets, designing a workable solution, though complicated, demands coordinated policies and cooperation.[26] To do otherwise would ignore the reality that modern markets are not bound by jurisdictional borders.

And fourth, this Commission historically has been a global leader in its commitment to applying principles of international comity, in the form of mutual recognition, in a variety of contexts. That commitment is reflected in the Commission's Part 30 rules,[27] which apply to foreign firms "with respect to the offer and sale of foreign

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[23] *Id.*

[24] *See F. Hoffman-LaRoche, Ltd. v. Empagran S.A.,* 542 U.S. 155, 164 (2004) (statutes should be construed to "avoid unreasonable interference with the sovereign authority of other nations.").

[25] Dodd-Frank, Section 752(a).

[26] *See* Leaders' Statement from the 2009 G-20 Summit in Pittsburgh, Pa. ("G-20 Pittsburgh Leaders' Statement") at 7 (Sept. 24-25, 2009) ("We are committed to take action at the national and international level to raise standards together so that our national authorities implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage"), *available at* https://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf.

[27] 17 CFR part 30.

futures and options to U.S. customers and are designed to ensure that such products offered and sold in the U.S. are subject to regulatory safeguards comparable to those applicable to transactions entered into on designated contract markets."[28] It also is reflected in our approach (initially through staff no-action relief, and later through registration after Dodd-Frank) to foreign boards of trade ("FBOTs") offering US participants "direct access" to enter trades directly into the FBOT's order entry and trade matching systems.[29] And just recently, it was reflected in the Commission's proposal to amend Rule 3.10(c)(3) to permit non-US commodity pool operators to claim exemption from CFTC registration for offshore commodity pools with no US participants on a pool-by-pool basis.[30]

When the Commission issued the Guidance in 2013, only a few derivatives reforms had been adopted in a few other jurisdictions. How things have changed since then. Many of our fellow regulators in the world's major financial centers have implemented reforms governing the conduct of swap dealers commensurate to our own, and extensive strides have been made (and continue to be made) towards international harmonization – thereby aligning our regulatory principles, just as the G-20 envisioned. As a result, most swaps involving non-US counterparties today are expected to be subject to foreign regulatory requirements similar to the Commission's own, unlike at the time

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[28] Foreign Futures and Options Transactions, 85 FR 15359, 15360 (March 18, 2020).

[29] *See* Statement of Commissioner Dawn D. Stump Regarding Foreign Board of Trade Registration Applications of Euronext Amsterdam, Euronext Paris, and European Energy Exchange (November 5, 2019), available at https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement110519.

[30] Exemption From Registration for Certain Foreign Persons Acting as Commodity Pool Operators of Offshore Commodity Pools, 85 Fed. Reg. 35820 (June 12, 2020); *see also* Commissioner Stump Part 3 Statement, n.15, *supra.*

the Guidance was adopted.[31] Further, our deference to the comprehensive swap regulation of our international colleagues has been demonstrated by the fact that since the Guidance was issued, the CFTC has issued 11 comparability determinations regarding the regulation of swap dealers in the European Union, Canada, Japan, Australia, Hong Kong, and Switzerland.

Thus, regulation of global swap markets that imposes overlapping and duplicative requirements on swap dealers and their cross-border activities by multiple regulators is inconsistent with: 1) principles of statutory interpretation; 2) Congress' direction to the Commission; 3) the vision of the G-20 Leaders at the Pittsburgh Summit; and 4) the Commission's own longstanding commitment to international comity through mutual recognition of foreign regulatory regimes. In a word: It is not workable.

Conclusion

In conclusion, I support codifying our prior cross-border Guidance into enforceable rules. I believe that the final rules before us today are clear, sensible, and workable, and that they appropriately apply the Commission's regulations to the cross-border activities of swap dealers. They improve upon the Guidance based on our experience in administering the Dodd-Frank swap regulatory regime over the past several

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[31] As recounted in the release, CEA Section 2(i) has its origins in an amendment that Rep. Spencer Bachus offered during the House Financial Services Committee markup on October 14, 2009, that would have restricted the Commission's jurisdiction over swaps between non-US resident persons. Chairman Frank opposed the amendment, noting that there may well be cases where non-US 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 US regulators from stepping in. Chairman Frank expressed his commitment to work with Rep. Bachus going forward, Rep. Bachus withdrew the amendment, and eventually Section 2(i) was included in Dodd-Frank. *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). For the reasons discussed in text, the prospect of swaps between non-US counterparties being insufficiently regulated internationally is far less today than it was when the extraterritoriality of the CFTC's jurisdiction over swaps was being debated.

years, and they recognize the current state of global regulation of globally interconnected derivatives markets by carrying on this agency's established tradition of mutual recognition and substituted compliance.

I therefore support the final cross-border rules for swap dealers before us today. I want to very much thank the staff of the Division of Swap Dealer and Intermediary Oversight, the General Counsel's Office, and the Chief Economist's Office for their efforts in preparing this rulemaking. I am particularly appreciative of the time that the staff devoted to answering our diverse questions – always in a thoughtful and comprehensive manner – and reviewing and addressing the various comments and requests from me and my team.

Appendix 6 – Dissenting Statement of Commissioner Dan M. Berkovitz

Introduction

I dissent from today's final cross-border swap rulemaking (the "Final Rule"). As described by the Chairman, this Final Rule will "pare[] back our extraterritorial application of our swap dealer regime."[1] Over the past seven years, the current cross-border regime has helped protect the U.S. financial system from risky overseas swap activity. The Commission should not be paring back these protections for the American financial system, particularly now, during a global pandemic.

The Final Rule will permit U.S. swap dealers to book their swaps with non-U.S. persons in offshore affiliates, thereby avoiding the CFTC's swap regulations, even when they conduct those swap activities from within the United States and the U.S. parent

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[1] Kadhim Shubber, Financial Times, *US regulator investigates oil fund disclosures* (July 15, 2020), available at https://www.ft.com/content/1e689137-2d1f-4393-a18f-fe0da02141cc.

retains the risks from those swap activities. The structure of the Final Rule practically invites multinational U.S. banks and hedge funds to book their swaps in offshore affiliates to avoid our swap dealer regulations. This will permit risks to flow back into the United States with none of the intended regulatory protections.

The Commission defends its retreat by citing principles of international comity and asserting that compliance with the laws of another jurisdiction in lieu of the CFTC's requirements will be permitted only when the CFTC finds that the laws of the other jurisdiction are "comparable" to those of the CFTC. The Final Rule, however, establishes a weak and vague standard for determining when the swap regulations of another jurisdiction are comparable. Further, the Final Rule even permits substituted compliance where the swap activity occurs within the United States—such as for swaps between a U.S. branch of a non-U.S. swap dealer and another non-U.S. person, even if those swaps are negotiated and booked in the United States. The Commission is not permitted to defer to regulators in other jurisdictions when the swap activity is conducted within the United States, nor should it do so even if such deference were permitted.

As I noted in my dissent on the proposed rule, experience has taught us that while finance may be global, global financial rescues are American. We should not loosely outsource the protection of the U.S. financial system and American taxpayers to foreign regulators that are unaccountable to the American people.

Less regulation of U.S. persons conducting swap activities outside the U.S.

In the Final Rule, the Commission acknowledges that cross-border swaps activities can have a "direct and significant" connection with activities in, or effect on, U.S. commerce. The Final Rule, however, removes several key protections in the 2013

Cross-Border Guidance ("Guidance")[2] that mitigated the risks arising from such cross-border activities.[3] The Final Rule narrows the definition of "guarantee" in a legalistic manner, permitting banks to craft financing arrangements for their overseas swap activities that bring risks back into the U.S. parent organization without triggering the application of Dodd-Frank requirements for those activities. The Final Rule also discards the Guidance's firewalls that were designed to prevent banks from evading Dodd-Frank requirements by using foreign affiliates as the front office for swaps with non-U.S. persons while bringing the risk from those swaps back to the U.S. home office through back-to-back internal swaps ("affiliate conduits").

The Final Rule creates a new category of entities—the SRS—supposedly to capture the risks arising from the swap activities of very large foreign affiliates of U.S. firms. But the Commission admits that this new category likely will include "few, if any" entities.[4] Most likely, therefore, the SRS construct will provide no protections to the financial system from the swap activities of overseas affiliates of U.S. entities that bring

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[2] Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 FR 45292, 45298-45301 (July 26, 2013).

[3] The preamble to the final rule observes (Sec. I.C.):

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. [footnote omitted]. 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 Final 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.

[4] Final Rule release, Sec. X.C.3.

risks to their U.S. parents and to the U.S. financial system. Each of these significant deficiencies is discussed in greater detail below.

Swap activity outside the U.S. guaranteed by a U.S. Person. The Guidance provided that when a swap of a non-U.S. person is guaranteed by a U.S. person, then the Dodd-Frank requirements regarding swap dealer registration and many of the attendant swap dealer regulations would apply to that non-U.S. person in the same manner as they would apply to a U.S. person. This is because a swap conducted by a non-U.S. person guaranteed by a U.S. person poses essentially the same risks to the U.S. financial system as a swap conducted by a U.S. person.[5] The Guidance adopted a functional rather than literal approach to the term "guarantee":

> The Commission also is affirming that, for purposes of this Guidance, the Commission 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 with respect to its swaps. The Commission believes that it is necessary to interpret the term "guarantee" to include the different financial arrangements and structures that transfer risk directly back to the United States. In this regard, it is the substance, rather than the form, of the arrangement that determines whether the arrangement should be considered a guarantee for purposes of the application of section 2(i).[6]

The Final Rule, however, adopts a narrow, legalistic definition of guarantee: "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

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[5] "The Commission believes that swap activities outside the U.S. that are guaranteed by U.S. persons would generally have a direct and significant connection with activities in, or effect on, U.S. commerce in a similar manner as the underlying swap would generally have a direct and significant connection with activities in, and effect on, U.S. commerce if the guaranteed counterparty to the underlying swap were a U.S. person." Cross-Border Guidance, 78 FR at 45319.

[6] *Id*. at 45320 (footnotes omitted).

swap."[7] The Commission recognizes that this definition is "narrower" than the definition in the Guidance, and that this narrower definition could result in increased risk to the U.S. financial system.[8] The Commission further acknowledges that this narrower definition "could lead to certain entities counting fewer swaps towards their de minimis threshold or qualify additional counterparties for exceptions to certain regulatory requirements as compared to the definition in the Guidance."[9]

The Commission asserts, however, that the narrower definition is "more workable" because it is consistent with the definition of guarantee in the Cross-Border Margin Rule, and therefore will not require an "independent assessment."[10] The Commission presents no evidence, however, as to why the current definition, which has now been in place for seven years, is not "workable," or why multinational financial institutions that trade hundreds of billions, and even trillions, of dollars of swaps on a daily basis are not capable of determining whether their overseas affiliates are guaranteed by a U.S. person. A global financial institution that cannot readily determine or represent whether or not the risks from its overseas swaps are guaranteed by one of its U.S. entities should not be a global financial institution.

Affiliate conduits. The Guidance also applied the Dodd-Frank swap dealer registration requirements, and many of the attendant swap dealer regulations, to the swap

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[7] Final Rule release, Section 23.23(a)(9).

[8] The Commission states that arrangements that would meet the broader definition in the Guidance, but are not within the narrower scope of the Final Rule, "transfer risk directly back to the U.S. financial system, with possible adverse effects, in a manner similar to a guarantee with direct recourse to a U.S. person." Final Rule release, Sec. II.C.3.

[9] *Id*.

[10] *Id*.

activities of “affiliate conduits”[11] of U.S. persons in the same manner as it applies to U.S. persons. Under the Guidance, a key factor in determining whether a non-U.S. person would be considered to be an affiliate conduit of a U.S. person is whether the non-U.S. person regularly enters into swaps with non-U.S. counterparties and then enters into “offsetting swaps or other arrangements with its U.S. affiliate(s) in order to transfer the risks and benefits of such swaps with third parties to its U.S. affiliates.”[12]

The affiliate conduit provisions in the Guidance were designed to prevent U.S. entities from booking those swaps in their non-U.S. affiliates to escape the CFTC’s Dodd-Frank requirements that would otherwise apply to the entity’s swap activity in the United States. The risks and benefits of those swaps booked offshore could then be transferred back to the U.S. with back-to-back internal swaps between the U.S. parent and its non-U.S. affiliate. Ultimately, risk from the swap would reside on the books of the U.S. entity. Through this back-to-back process, the U.S. entity could still conduct the swap activity, and bear the risk of the swaps, yet would avoid the application of CFTC requirements that would apply had the swap been booked directly in the U.S. entity.

The Final Rule does not include any comparable provisions to prevent the use of affiliate conduits to avoid CFTC regulation. This is an invitation to abuse and to risk for the U.S. financial system.

Significant risk subsidiary (SRS). The Final Rule adopts a new construct—the “significant risk subsidiary”—to supposedly encompass overseas affiliates of U.S.

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[11] The term “affiliate conduit” and “conduit affiliate” are used interchangeably. *See*, *e.g*., Cross-Border Guidance, 78 FR at 45319.

[12] The Commission explained, “the Commission believes that swap activities outside the United States of an affiliate conduit would generally have a direct and significant connection with activities in, or effect on, U.S. commerce in a similar manner as would be the case if the affiliate conduit’s U.S. affiliates entered into the swaps directly.” *Id*.

entities whose swap activities pose significant risks to the U.S. financial system. An SRS is defined as any non-U.S. "significant subsidiary" of an ultimate U.S. parent entity where that ultimate parent has more than $50 billion in global consolidated assets. An entity is a "significant subsidiary" if it has a sufficient size relative to its parent, measured in terms of percentage of either revenue, equity capital, or total assets.[13] However, the definition then excludes non-U.S. subsidiaries that are either (i) prudentially regulated by the Federal Reserve; or (ii) prudentially regulated by the entity's home country prudential regulator whose regulations are consistent with the Basel Committee's capital standards, and subject to comparable margin requirements for uncleared swaps in its home country. An entity that survives the gantlet of thresholds and exclusions to be considered an SRS would then be subject to the same registration requirements as a U.S. person, and many of the same regulatory requirements that apply to U.S. swap dealers. That outcome, however, is very unlikely. The threshold criteria to be a "significant subsidiary" are high, and because entities that meet these high thresholds are typically affiliated with prudentially-regulated banks, it is likely they will be excluded from the SRS definition. It therefore is improbable that any entities will fall into the SRS category. The Cost-Benefit Considerations in the notice of proposed rulemaking for the Final Rule concede that "few, if any" entities would fall within its ambit.[14]

[13] The Final Rule release asserts that the criteria for qualifying as a "significant subsidiary" are risk-based. The relative financial measures of revenue, equity capital, and total assets, however, are not related to the risks presented by the subsidiary's swap activity. These criteria have nothing at all to do with swaps and in no way a measure or reflect the risks posed by the subsidiary's swap activities.

[14] "Of the 61 non-U.S. SDs that were provisionally registered with the Commission in June 2020, the Commission believes that few, if any , will be classified as SRSs pursuant to the Final Rule." Final Rule release, Sec. X.C.3.

Furthermore, the criteria apply to each subsidiary separately. If an institution has a subsidiary that is approaching the high thresholds set in the Final Rule, it can incorporate another non-U.S. subsidiary and conduct swap dealing activity out of that entity to avoid SRS designation for any of its subsidiaries.

One commenter noted that the qualifications only indirectly address the significance of the subsidiary and suggested the test be modified to assess the extent to which swap risk is accepted by a non-U.S. subsidiary or transferred back to the subsidiary's U.S. affiliates.[15] The Commission characterized the suggested test as an activity-based test and rejected the commenter's proposed fix. On the other hand, when other commenters noted that subsidiaries that do not engage in any swap dealing activity would potentially be captured by the SRS qualifications—because the qualifications have *nothing to do with swaps*—the Commission modified the Final Rule with an activity-based end-user test to exempt those entities from the SRS category.

Under the Final Rule, a significant subsidiary that is regulated by U.S. or foreign banking regulators is *excluded* from the SRS category. "The Commission is excluding these entities from the definition of SRS, in large part, because the swaps entered into by such entities are already subject to significant regulation, either by the Federal Reserve Board or by the entity's home country."[16]

Here the Commission forgets the lessons of the 2008 financial crisis and ignores the mandate of Congress. Following the financial crisis—and as a result of the lessons

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[15] Better Markets, Comment Letter, Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, at 17 (Mar. 9, 2020); available at https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=29136.

[16] Final Rule release, Sec. II.D.3.iv.

learned during the crisis—Congress subjected the swaps markets to *both* prudential and market regulation. The Commodity Futures Modernization Act of 2000, which spectacularly failed to prevent the build-up of catastrophic systemic risks within the financial system leading to the 2008 financial crisis, was based on the premise that market regulation is unnecessary to protect against systemic risks for financial entities that are subject to prudential regulation.[17] Events taught us, however, that prudential regulation alone was insufficient to prevent the build-up of those risks to the financial system. Following the crisis, Congress mandated both prudential regulation and market regulation for banks conducting swap activities. The safeguards and protections to the financial system afforded under Title VII of the Dodd-Frank Act were to be applied regardless of the extent of prudential regulation. The prudential regulation in a non-U.S. jurisdiction of an affiliate of a U.S. swap dealer whose swaps risks are transferred back into the U.S. is not an adequate substitute for the protections mandated by Title VII of the Dodd-Frank Act.

The Commission does not dispute that the Final Rule will allow affiliates currently subjected to the Guidance provisions regarding guarantees and affiliate conduits affiliates to operate free of CFTC swap regulations. The Commission also acknowledges that the activities of these entities may pose risks to the U.S. financial system.[18] Not only

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[17] For a more detailed discussion of the financial firm failures involving cross border activity and related U.S. government and bail outs, see my dissenting statement to the Proposed Cross-border swap regulations (Dec. 18, 2019), available at https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement121819b.

[18] "The Commission is aware that many other types of financial arrangements or support, other than a guarantee as defined in the Final 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 adverse effects, in a manner similar to a guarantee with a direct recourse to a U.S. person." Final Rule release, Sec.II.C.3. See also

will the Final Rule permit risks to flow into the U.S., but it will provide an incentive for U.S. banks to move their swap activities into these foreign affiliates, where they can conduct the same activities but be free from the CFTC's regulations.

Less regulation of swap activity in the U.S.

ANE Swaps. In 2013, the CFTC issued a Staff Advisory addressing the applicability of the "Transaction-Level Requirements" to non-U.S. swap dealers that use persons in the U.S. to facilitate swap transactions with other non-U.S. persons. The CFTC staff observed that "persons regularly arranging, negotiating, or executing swaps for or on behalf of an SD [swap dealer] are performing core, front-office activities of that SD's dealing business," and declared that "the Commission has a strong supervisory interest in swap dealing activities that occur within the United States, regardless of the status of the counterparties."[19] The CFTC staff advised that a non-U.S. swap dealer "regularly using personnel or agents located in the U.S. to arrange, negotiate, or execute ["ANE"] a swap with a non-U.S. person generally would be required to comply with the Transaction-Level Requirements."[20]

The Staff Advisory prompted an outcry from non-U.S. swap dealers, including wholly-owned non-U.S. affiliates of U.S. financial institutions, who objected to the CFTC's imposition of its clearing, trade execution, reporting, and business conduct standards on their swaps with other non-U.S. persons. Non-U.S. dealers argued that the

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Final Rule release, Sec. II.D.3 (recognition that conduit affiliate structures may present significant risks to the U.S. financial system but determination not to apply de minimis registration threshold to a non-U.S. affiliates that is not an SRS).

[19] CFTC Staff Advisory 13-69, Division of Swap Dealer and Intermediary Oversight Advisory, Applicability of Transaction Level Requirements to Activity in the United States (Nov. 14, 2013), available at https://www.cftc.gov/csl/13-69/download.

[20] *Id*.

risks from these swap activities resided primarily in the home country, and warned that they may remove their swap dealing business from the U.S. if these requirements applied. Shortly thereafter, the CFTC staff provided no-action relief from the application of the Staff Advisory,[21] and the Commission issued a Request for Comment on whether the Commission should adopt the Staff Advisory, in whole or in part.[22]

The Final Rule discards the ANE concept entirely. "ANE transactions will not be considered a relevant factor for purposes of applying the Final Rule."[23]

The ability of non-U.S. persons to use personnel within the U.S., without limitation, to conduct their swap activities with other non-U.S. persons without CFTC

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[21] CFTC No-Action Letter No. 13-71, Certain Transaction-Level Requirements for Non-U.S. Swap Dealers (Nov. 26, 2013), available at https://www.cftc.gov/csl/13-71/download. This no-action relief has been extended multiple times and will continue in effect until the Final Rule becomes effective. Concurrent with the issuance of the Final Rule, the CFTC staff is extending this no-action relief for transaction-level requirements not addressed by the Final Rule (which includes requirements relating to clearing, trade-execution, and real-time public reporting). At the same time, the staff is withdrawing the 2013 Staff Advisory as it applies to all transaction-level requirements, including requirements not addressed in the Final Rule. In conjunction with the Commission's consideration of the Final Rule, both of these staff actions were presented to the Commission in a single package under the "Absent Objection" process, with any objections due the day before the Commission is scheduled to vote on the Final Rule. Although I would support the extension of this no-action relief for such transactions not covered by this rulemaking, were it issued separately, I cannot support, in conjunction with this rulemaking, the withdrawal of the ANE advisory for transactions not covered by the Final Rule. The withdrawal of the Staff Advisory for transactions not covered by the rulemaking is being taken in response to selected comments received as part of the rulemaking, yet the public was not afforded notice and opportunity for comment as to the manner in which the Commission should address transaction-level requirements not within the scope of the rulemaking. It would have been just as workable for market participants to provide the no-action relief while maintaining the Staff Advisory. Accordingly, I have objected to the "Absent Objection" package presented to the Commission that included both the withdrawal of the Staff Advisory and the extension of no-action relief for transactions not covered by the Final Rule.

[22] 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).

[23] Final Rule release, Sec. V.C. The Securities and Exchange Commission ("SEC") requires a non-U.S. person to include ANE transactions in determining whether the amount of its swap dealing activity exceeds the de minimis threshold for registration. Cross-Border Application of Certain Security-Based Swap Requirements, 85 FR 6270, 6272 (Feb. 4, 2020), available at https://www.federalregister.gov/documents/2020/02/04/2019-27760/cross-border-application-of-certain-security-based-swap-requirements. The preamble to the Final Rule includes many statements regarding the importance of "harmonization" with the SEC rules. However, on this issue, which imposes a more stringent result for potential swap dealers, the Commission has decided *not* to harmonize with the SEC.

regulation or oversight could have a variety of detrimental consequences. Foremost among these is the possibility, perhaps even likelihood, that U.S. swap dealers will move the booking of their swaps with non-U.S. persons (including non-U.S. affiliates of other U.S. firms) into their own non-U.S. affiliates, while maintaining the U.S. location of the personnel conducting the swap business, in order to avoid the application of the Dodd-Frank requirements to those transactions. In fact, Citadel noted in its comments on the proposed rule that this may be happening already. Citadel stated that "market transparency in EUR interest rate swaps for U.S. investors has been greatly reduced based on data showing that, following issuance of the ANE No-Action Relief, interdealer trading activity in EUR interest rate swaps began to be booked almost exclusively to non-U.S. entities, a fact pattern that Citadel believes is 'consistent with (although not direct proof of) swap dealers strategically choosing the location of the desk executing a particular trade in order to avoid trading in a more transparent and competitive setting.'"[24]

[24] Final Rule release, Sec. V.C. In support of this assertion, Citadel cites Evangelos Benos, Richard Payne and Michalis Vasios, Bank of England Staff Working Paper (No. 580), Centralized trading, transparency and interest rate swap market liquidity: evidence from the implementation of the Dodd-Frank Act (May 2018), available at: https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2018/centralized-trading-transparency-and-interest-rate-swap-market-liquidity-update. In addition to the language quoted by Citadel, this study concluded:

Additionally, we find that, for the EUR-denominated swap market, the bulk of interdealer trading previously executed between US and non-US trading desks is now largely executed by the non-US (mostly European) trading desks of the same institutions (i.e. banks have shifted inter-dealer trading of their EUR swap positions from their US desks to their European desks). We interpret this as an indication that swap dealers wish to avoid being captured by the SEF trading mandate and the associated impartial access requirements. Migrating the EUR inter-dealer volume off-SEFs enables dealers to choose who to trade with and (more importantly) who not to trade with. This might allow them to erect barriers to potential entrants to the dealing community. Thus this fragmentation of the global market may be interpreted as dealers trying to retain market power, where possible. Importantly, we find no evidence that customers in EUR swap markets try to avoid SEF trading and the improved liquidity it delivers.

Id. at 31-32.

If more than one U.S. swap dealer were to employ this strategy, the result could be that swap activity between two U.S. swap dealers that currently takes place within the U.S. and is fully subject to the CFTC's swap regulations might then be booked in two non-U.S. affiliates outside the United States. So long as the U.S. parents do not provide explicit guarantees for the swaps of the subsidiaries,[25] the trading between these subsidiaries would not count toward the dealer registration threshold. Furthermore, even if one of those non-U.S. entities were a registered swap dealer, the trading would not be subject to any CFTC transaction-level requirements, even though the risk from those transactions is ultimately borne by the U.S. parent through consolidated accounting, and U.S. personnel would be negotiating those transactions.[26]

U.S. banks already conduct a significant amount of inter-bank business through their non-U.S. affiliates. Data from swap data repositories shows that U.S. bank swap dealers commonly book swaps with each other through their respective non-U.S. subsidiaries. For a recent one-year period, the data shows that a number of U.S. banks booked more than 10 percent—and in some cases close to 50 percent—of the reported notional amount of swaps across their entire bank-to-bank swaps books through non-U.S. subsidiaries. In other words, a number of U.S. banks are already booking material

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[25] Even in the absence of an explicit guarantee or other financial support, there is likely an expectation that the U.S. parent will ensure the subsidiary has sufficient funds to pay its swap obligations. The U.S. parent has substantial reputation risk if its subsidiaries start defaulting on their swaps. The expansive definition of "guarantee" in the Guidance is perhaps one reason that U.S. banks that withdrew the explicit guarantees provided their affiliates have not yet attempted to withdraw their swap dealer registration. Further regulatory uncertainty about the viability of de-registering may have arisen from the cross-border rule proposed by the Commission in 2016 that would have treated non-U.S. affiliates that were consolidated subsidiaries of U.S. persons as U.S. persons.

[26] This strategy would be less effective if either of the non-U.S. affiliates were an SRS. However, as described above, it is likely that "few, if any," non-U.S. affiliates will be captured within this definition particularly affiliates of prudentially regulated banks, which are excepted out of the definition altogether.

amounts of swaps with each other through their non-U.S. wholly-owned consolidated subsidiaries.

Non-U.S. banks conducting swap activity in the U.S. The Final Rule reverses the position taken by the Commission in the proposed rule that would have prevented a U.S. branch of a non-U.S. swap entity from obtaining substituted compliance for various transactional requirements for swaps with non-U.S. swap entities that are booked in the U.S. branch.[27] The cross-border notice of proposed rulemaking upon which the Final Rule is based ("2019 Proposal") would have permitted substituted compliance only for the foreign-based swaps of a non-U.S. swap entity. Both under the 2019 Proposal and the Final Rule, a swap conducted by a non-U.S. swap entity through a U.S. branch would not be considered a "foreign-based swap."

Sensibly, under the 2019 Proposal, substituted compliance would be available only for foreign-based swaps. As the Commission explained in the 2019 Proposal, "[t]he 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. . . ."[28]

Although the Commission repeats nearly verbatim the rationale articulated in the 2019 Proposal for applying CFTC regulations without substituted compliance to transactions booked in the United States, conducted in the United States, and within an organization regulated under the laws of the United States, the Final Rule now excludes

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[27] 2019 Proposal, rule text, Sec. 23.23(e)(3), 85 FR 952, 1004.

[28] 2019 Proposal, 85 FR 952, 968.

swaps booked in a U.S. branch of a non-U.S. swap entity from this general principle, and permits it to obtain substituted compliance for its transactions with non-U.S. persons.[29]

The Commission has no authority to grant substituted compliance for transactions occurring within the United States. The ability of the Commission to consider international comity in determining whether to apply CFTC regulations or permit substituted compliance with the laws of a foreign regulator only applies with respect to activities outside the United States. The Final Rule defines a "foreign-based swap" in a manner that does not include swaps booked in the U.S. branch of a non-U.S. swap entity. The fact that one of the counterparties to a transaction is owned by a non-U.S. entity does not transform activity conducted by that entity within the United States into foreign activity. Thus, the Final Rule not only retreats from the application of U.S. law to transactions that are arranged, negotiated, and executed in the United States, it even retreats from the application of U.S. law to transactions that are booked in the United States. This is not in accordance with either Section 2(i) of the Commodity Exchange Act ("CEA"), which limits the application of the swaps provisions of the CEA only with respect to activities outside the United States, or with the principles of international comity, which the Commission recognizes only applies with respect to activity occurring in another jurisdiction.

[29] The Commission's adoption of the opposite of what was proposed also presents significant notice and comment issues under the Administrative Procedure Act. *See Environmental Integrity Project v. EPA*, 425 F.3d 992, 998 ("Whatever a "logical outgrowth" of this proposal may include, it certainly does not include the Agency's decision to repudiate its proposed interpretation and adopt its inverse."); *Chocolate Mfrs. Ass'n v. Block*, 755 F.2d 1098, 1104 ("An agency, however, does not have carte blanche to establish a rule contrary to its original proposal simply because it receives suggestions to alter it during the comment period.").

Weakening the Standards for Substituted Compliance

I agree with the Commission's interpretation of CEA Section 2(i) that international comity is an important consideration in determining the extent to which the CEA and the CFTC's swap regulations should apply to cross-border swap activity occurring in another jurisdiction. I have voted for every substituted compliance determination presented to the Commission during my tenure under the standards adopted in the Guidance.

The standards established in the Final Rule for substituted compliance determinations, however, depart significantly from the current standards. The Final Rule creates a lesser standard that permits a finding of comparability if the Commission determines that "some or all of the relevant foreign jurisdiction's standards are comparable . . . or would result in comparable outcomes . . . ."[30] Under the Guidance, however, the Commission must also find that the regulations of the other jurisdiction are as "comprehensive" as the Commission's regulations. Furthermore, the Final Rule permits the Commission to consider any factors it "determines are appropriate, which *may* include"[31] any of four factors listed in the Final Rule. This "standard for review" is not a standard at all. It permits the Commission to withdraw the cross-border application of its regulations regardless of the robustness of the other jurisdiction's regulatory regime, for whatever reasons the Commission chooses. In the absence of more rigorous, objective criteria, it will be very difficult for the Commission to deny requests from other jurisdictions or market participants for comparability determinations.

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[30] Final Rule, rule text, section 23.23(g)(4).

[31] *Id*.

Conclusion

The Final Rule is a significant retreat from the robust yet balanced cross-border framework presented in the Guidance. The current framework has worked well to both protect the U.S. financial system from systemic risks arising from swap activities outside the U.S. and recognize the interests of other nations in regulating conduct within their own borders. The Final Rule destroys this balance.

I cannot support this abdication of responsibility to protect the U.S. financial markets and the American taxpayer.

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