ALERT MEMORANDUM

Cross-Border 3.0? CFTC Proposes Revision and Codification of Cross-Border Swaps Guidance

December 31, 2019

On December 18, 2019, the Commodity Futures Trading Commission (the "**CFTC**" or "**Commission**"), in a 3 to 2 vote, proposed rules (the "**Proposed Rules**") that would, if finalized, supersede the Commission's current policy with respect to the cross-border application of swaps regulations under Commodity Exchange Act ("**CEA**") Section 2(i), as set forth in the guidance published by the CFTC in July 2013 (the "**2013 Guidance**").[1]

More specifically, the Proposed Rules would classify swap market participants (*e.g.*, U.S. person, guaranteed entity, foreign branch), address which cross-border or extraterritorial swaps or swap positions a person would need to consider when determining whether it needs to register with the Commission as a swap dealer ("**SD**") or major swap participant ("**MSP**" and, together with SDs, "**Swap Entities**"), categorize certain swaps requirements applicable to Swap Entities for purposes of how they apply to cross-border or extraterritorial swaps transactions, and codify a process for the CFTC to permit Swap Entities to substitute compliance with comparable foreign requirements.

OVERVIEW OF THE PROPOSED RULES

Since July 2013, the cross-border application of the CFTC's swaps rules has been governed by the 2013 Guidance, a policy statement that, unlike a formal rule, is not legally binding on the CFTC or market participants. The CFTC has frequently sought to revisit the 2013 Guidance, most recently in a white paper published by former Chairman J. Christopher Giancarlo, [2] and previously in a rule proposal issued in late 2016 under then-Chairman Timothy Massad (the "**2016 Proposal**")[3] and staff guidance published in November 2013 ("**Advisory 13-69**"),[4] which was quickly superseded by no-action relief that remains in effect today.[5]

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[1] Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45292 (July 26, 2013).
[2] CFTC Chairman J. Christopher Giancarlo, "Cross Border Swaps Regulation Version 2.0: A Risk-Based Approach with Deference to Comparable Non-US Regulation" (Oct. 1, 2018), available at: https://www.cftc.gov/sites/default/files/2018-10/Whitepaper_CBSR100118_0.pdf. Our Alert Memorandum regarding this white paper can be found at https://www.clearygottlieb.com/-/media/files/alert-memos-2018/cftc-chairman-proposes-crossborder-swaps-regulation-version.pdf.
[3] Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to [SDs] and [MSPs], 81 Fed. Reg. 71946 (Oct. 18, 2016).
[4] CFTC Staff Advisory No. 13-69 (Nov. 14, 2013).
[5] *See, e.g.*, CFTC No-Action Letter No. 17-36 (July 25, 2017).

If, unlike his predecessors, Chairman Heath Tarbert is successful in codifying a final cross-border rule, it will be a significant achievement—especially considering the CFTC's crowded agenda over the course of the next year and the significant controversy that frequently attaches to rulemakings in this area.

The key elements of the Proposed Rules are as follows:

Key Definitions. The Proposed Rules would eliminate the concept of a "conduit affiliate" from the 2013 Guidance and replace it with a new class of entity defined as a "significant risk subsidiary." The Proposed Rules would also clarify and streamline a number of key definitions from the 2013 Guidance, such as "U.S. person" and "guarantee," to harmonize with related CFTC and Securities and Exchange Commission ("**SEC**") rules. The Proposed Rules also would, for the first time, introduce new definitions relating to U.S. branches of non-U.S. banks.

These definitional changes comprise perhaps the most controversial aspects of the Proposed Rules; in particular, the dissenting Commissioners strongly challenged the new "guarantee" definition, which is narrower—but much clearer—than the parallel definition in the 2013 Guidance, and the "significant risk subsidiary" definition, which is much narrower and more risk-focused than the "foreign consolidated subsidiary" definition from the 2016 Proposal.

ANE Transactions. In contrast to the approach taken by the SEC and Advisory 13-69, but consistent with the 2013 Guidance, the CFTC would not apply swaps-related requirements, other than anti-fraud and anti-manipulation rules, to transactions between non-U.S. counterparties that are arranged, negotiated or executed by U.S.-located personnel or agents ("**ANE Transactions**"), so long as neither non-U.S. counterparty is a significant risk subsidiary or guaranteed by a U.S. person.

Registration Thresholds. The Proposed Rules would largely codify the 2013 Guidance with respect to which cross-border swaps transactions and positions a person would need to consider when determining whether it needs to register as a Swap Entity with the CFTC, subject to conforming changes appropriate to reflect the revised definitions noted above.

Categorization of Swap Dealer Requirements. The Proposed Rules would categorize certain of the entity-level and transaction-level requirements from the 2013 Guidance into Group A, B, or C requirements, each with corresponding eligibility for exceptions and/or substituted compliance. Again, here the Proposed Rules would mostly codify the 2013 Guidance. Notably, however, the Proposed Rules do not address mandatory clearing, mandatory trade execution, real-time public reporting or swap data reporting requirements, which would continue to be governed by the 2013 Guidance pending any further CFTC rulemaking.

Recordkeeping. The Proposed Rules would require Swap Entities to create a record of their compliance with the Proposed Rules and to retain such records.

Comment Period. The comment period for the Proposed Rules will be 60 days after the date of publication in the Federal Register.

BACKGROUND

The CFTC's 2013 Guidance interpreted and applied Section 2(i) of the CEA. Section 2(i) provides that the CEA's swaps-related provisions shall not apply to activities outside the United States unless those activities (1) have a direct and significant connection with activities in, or effect on, U.S. commerce or (2) contravene CFTC anti-evasion rules.

Under the 2013 Guidance, the extent to which the CFTC's swaps regulations apply to a swap depends on whether the swap is entered into by a U.S. person, a foreign branch of a U.S. bank ("**foreign branch**"), a guaranteed affiliate of a U.S. person, or a conduit affiliate of a U.S. person.[6] The 2013 Guidance includes definitions for these categories of market participants, addresses how SD and MSP registration requirements apply to swaps entered into by each category, divides most of the remaining swaps regulations into "Entity-Level Requirements" or "Transaction-Level Requirements," and addresses how those requirements apply to swaps entered into by each category. The 2013 Guidance also addresses when the CFTC permits substituted compliance with comparable foreign regulation and how it determines comparability.

The CFTC subsequently issued comparability determinations, exemptions, staff no-action letters and staff advisories that have supplemented the 2013 Guidance, including Advisory 13-69 and a series of related no-action letters that address ANE Transactions.[7]

In May 2016, the CFTC adopted rules ("**Cross-Border Margin Rules**") that supersede the 2013 Guidance with respect to the cross-border application of margin requirements for uncleared swaps of SDs and MSPs that do not have a prudential regulator.[8] The Cross-Border Margin Rules include a revised "U.S. person" definition, a revised "guarantee" definition, and a new category for foreign consolidated subsidiaries ("**FCSs**")[9] of U.S. persons. The Cross-Border Margin Rules also expand the extent to which margin requirements apply extraterritorially to non-U.S. persons guaranteed by U.S. persons ("**Guaranteed Entities**") and FCSs and revised the extent to which the CFTC permits substituted compliance with comparable foreign margin rules.

In October 2016, the CFTC published the 2016 Proposal, which proposed to (1) expand the extraterritorial application of SD and MSP registration requirements by treating Foreign Branches, Guaranteed Entities and FCSs like U.S. persons and (2) apply a subset of SD/MSP external business conduct standards to ANE Transactions.

On October 1, 2018, former Chairman J. Christopher Giancarlo released a white paper entitled "Cross-Border Swaps Regulation Version 2.0: A Risk-Based Approach with Deference to Comparable Non-U.S. Regulation" (the "**Giancarlo White Paper**"). The Giancarlo White Paper made proposals in a number of areas of cross-border regulation, including: registration of non-U.S. central counterparties, trading venues and SDs;, cross-border application of mandatory clearing and trade execution requirements; and regulation of ANE Transactions.

[6] The 2013 Guidance defines a "conduit affiliate" to mean a non-U.S. person that satisfies certain factors, including whether the non-U.S. person: (1) is a majority-owned affiliate of a U.S. person; (2) is controlling, controlled by or under common control with the U.S. person; (3) has financial results that are included in the consolidated financial statements of the U.S. person; and (4) 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. 2013 Guidance, 78 Fed. Reg, at 45359.

[7] *See, e.g.*, CFTC No-Action Letter No. 17-36 (July 25, 2017).

[8] Margin Requirements for Uncleared Swaps for [SDs] and [MSPs]—Cross-Border Application of the Margin Requirements, 81 Fed. Reg. 34818 (May 31, 2016).

[9] An FCS is a non-U.S. person in which an ultimate parent entity that is a U.S. person has a controlling financial interest, in accordance with U.S. Generally Accepted Accounting Principles ("**U.S. GAAP**"), such that the U.S. ultimate parent entity includes the non-U.S. person's operating results, financial position, and statement of cash flows in the U.S. ultimate parent entity's consolidated financial statements, in accordance with U.S. GAAP. *See* 17 C.F.R. § 23.160(a)(1).

KEY DEFINITIONS

(1) Overview

Under the 2013 Guidance, whether and when transactions or counterparties are subject to CFTC swaps regulations depends in part on certain definitions outlined in the 2013 Guidance, including the definitions of U.S. person, guaranteed affiliate and foreign branch. The Proposed Rules would revise many of those definitions, and introduce new ones.

The Proposed Rules, consistent with the Commission's approach in other contexts, would permit a person to 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 described below, unless such person knows or has reason to know that the representation is not accurate.

> The Proposed Rules would expressly permit reliance on U.S. person representations made with respect to the Cross-Border Margin Rules until December 31, 2025, as those definitions are largely consistent.[10] However, the practical utility of that exception may be limited as the Proposed Rules would likely require updates to a variety of counterparty representations due to definitional changes to defined terms other than the U.S. person definition.

(2) U.S. Person

The CFTC would simplify its U.S. person definition to be consistent with the definition from the SEC's parallel cross-border rules for security-based swaps.[11] Specifically, a U.S. person would be defined as:

(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.

To harmonize the CFTC's U.S. person definition with the SEC's definition, the Proposed Rules would define the phrase "principal place of business" as used in prong (2) above as "the location from which the officers, partners, or managers of the legal person primarily direct, control, and coordinate the activities of the legal person."[12] For externally managed investment vehicles, the principal place of business would be the location from where the manager of the vehicle "primarily directs, controls, and coordinates the investment activities of the vehicle." Although this definition is generally consistent with the 2013 Guidance, it would eliminate an additional prong of that definition capturing the location of senior personnel of a collective investment vehicle responsible for "the formation and promotion of the collective investment vehicle."[13]

The Proposed Rules would further harmonize the CFTC's U.S. Person definition with the SEC's definition by excluding certain international financial institutions, such as the World Bank and the International Monetary Fund.[14]

The Proposed Rules would also eliminate certain prongs that had been included in the U.S. person definition under the 2013 Guidance, including (1) pension plans for personnel at legal entities organized in the U.S. or with a principal place of business in the U.S., (2) trusts governed by the laws of a U.S. jurisdiction and subject to a U.S. court's primary supervision, (3) collective investment vehicles

[10] See CFTC Rule 23.402(d); Cross-Border Margin Rule, 81 FR at 34827; 2013 Guidance, 78 FR at 45315.
[11] *See* 17 C.F.R. § 3a71-3(a)(4).
[12] The Proposed Rules would define "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 shares, by contract, or otherwise."
[13] 2013 Guidance, 78 FR at 45310.
[14] Specifically, the definition would exclude 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.

majority-owned by one or more U.S. person(s), and (4) legal entities owned by one or more U.S. person(s) who bear unlimited responsibility for the obligations and liabilities of the legal entity.

Finally, the scope of the U.S. person definition from the Proposed Rules is expressly limited to its terms, rather than a non-exclusive definition as used the 2013 Guidance.

As a practical matter, elimination of the additional prongs from the 2013 Guidance would likely have a limited impact, only reducing the scope of covered persons at the margins as persons captured by those specialized prongs would often also be captured by more generalized prongs under the Proposed Rules. However, the revised, simplified definition under the Proposed Rules would make it far easier for Swap Entities to determine their counterparties' U.S. person statuses based on externally visible factors, for example because they would no longer need to determine the U.S. person ownership of collective investment vehicles.

(3) Guarantee

Consistent with the Cross-Border Margin Rule and parallel SEC rules, the Proposed Rules would narrow the scope of the term "guarantee" to mean an arrangement, pursuant to which one party to a swap has rights of recourse against a guarantor with respect to its counterparty's obligations under the swap. For these purposes, a party to a swap would have rights of recourse against a guarantor if the party had a conditional or unconditional legally enforceable right to receive or otherwise collect payments from the guarantor with respect to its counterparty's obligations under the swap. Also, the term "guarantee" would encompass any arrangement pursuant to which the guarantor itself has a conditional or unconditional legally enforceable right to receive or otherwise collect, in whole or in part, payments from any other guarantor with respect to the counterparty's obligations under the swap.

The CFTC also clarified in the Proposed Rules that a non-U.S. person would be considered a "guaranteed entity" only with respect to swaps that are guaranteed by a U.S. person. Accordingly, A non-U.S. person could be a Guaranteed Entity with respect to certain swaps with certain counterparties subject to a U.S.-Person guarantee, but would not be a Guaranteed Entity with respect to other swaps with other counterparties for which the non-U.S. person's swaps are not guaranteed by a U.S. person.

The definition of "guarantee" under the 2013 Guidance includes not only these traditional guarantees of payment or performance of the related swaps, but also other formal arrangements that support the non-U.S. person's ability to pay or perform its swap obligations (*e.g.*, keepwells and liquidity puts, certain types of indemnity agreements, master trust agreements, liability or loss transfer or sharing agreements). In narrowing the guarantee definition, the CFTC noted that concerns arising from limiting the scope of the guarantee definition would be mitigated by the addition of the concept of a "significant risk subsidiary," as described below.

The 2013 Guidance's broader "guarantee" definition has presented many challenges, for example making it difficult for Swap Entities to determine whether their non-U.S. counterparty has a guarantee because the definition encompasses arrangements that are purely internal to the counterparty's corporate group. Some also have considered that definition to be insufficiently broad because it did not prevent many firms from "de-guaranteeing" in 2014, which led to the much broader FCS concept introduced in the Cross-Border Margin Rule and 2016 Proposal. As described below, however, it is questionable whether the CFTC has authority to extend the extraterritorial reach of its rules based on accounting consolidation tests like those reflected in the 2016 Proposal and the Proposed Rules' "significant risk subsidiary" definition.

(4) Significant Risk Subsidiary

As noted above, the Proposed Rules include a new category of non-U.S. person, a significant risk subsidiary ("**SRS**"). The definition would capture certain "significant subsidiaries." A non-U.S. person would only be considered a "significant subsidiary" if it passes at least one of following three tests for significance relative to its ultimate U.S. parent entity:[15]

(A) the three-year rolling average of the subsidiary's equity capital[16] 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");

(B) 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

(C) 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").

This concept of a "significant subsidiary" borrows from the SEC's definition of "significant subsidiary" in Regulation S-X, as well as the Board of Governors of the Federal Reserve System ("**Federal Reserve Board**") in its financial statement filing requirements for foreign subsidiaries of U.S. banking organizations.

A significant subsidiary would only be considered an SRS if:

(1) its 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;[17] and

[15] The Proposed Rules define an "ultimate U.S. parent entity" for purposes of the significant subsidiary test as the U.S. parent entity that is not a subsidiary of any other U.S. parent entity. This definition would encompass U.S. parent entities that may be intermediate entities in a consolidated corporate family with an ultimate parent entity located outside the United States.

[16] Equity capital would include perpetual preferred stock, common stock, capital surplus, retained earnings, accumulated other comprehensive income and other equity capital components and should be calculated in accordance with U.S. GAAP.

[17] The $50 billion consolidated asset threshold has been used in other contexts as a measure of large, complex institutions that may have systemic impacts on the U.S. financial system. For example, the Financial Stability Oversight Council initially used a $50 billion total consolidated assets quantitative test as one threshold to apply to nonbank financial entities when assessing risks to U.S. financial stability. See Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, Financial Stability Oversight Council, 77 FR 21637, 21643, 21661 (Apr. 2012).

(2) the non-U.S. person is not subject to either:

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

(b) both (i) 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 (ii) margin requirements for uncleared swaps in a jurisdiction for which the Commission has issued a comparability determination with respect to uncleared swap margin requirements.

The SRS definition would replace the "conduit affiliate" definition from the 2013 Guidance, and is based on the concept of an FCS from the CFTC Cross-Border Margin Rules. The narrower scope of the SRS definition better reflects a risk-based approach to regulation of FCSs because the definition does not cover subsidiaries that are not significant to their U.S. parents, subsidiaries of groups that are not significant to the U.S. financial systems nor subsidiaries subject to prudential regulation. As a result, however, relatively few entities are likely to qualify as SRSs, which prompted significant criticism from the dissenting Commissioners. On the other hand, by focusing on significance, the Proposed Rules do not squarely address critics of the 2016 Proposal who expressed the view that accounting consolidation is not sufficient to satisfy the requirement in CEA Section 2(i) for a "direct" U.S. connection or effect.

For a flowchart prepared by the CFTC showing the application of the SRS tests, see Appendix A.

(5) <u>Foreign Branch and Swap Conducted Through a Foreign Branch</u>.

As discussed in further detail below, transactions with, or conducted through, the foreign branch of a U.S. swap dealer are in some cases subject to a more limited scope of CFTC requirements. Under the Proposed Rules, 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.

The Proposed Rules' definition of foreign branch is consistent with the SEC's definition, other than the requirement for foreign branches to maintain 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. However, this extra condition seems unlikely to impede the ability of branches to qualify for foreign branch status.

Additionally, under the Proposed Rules, 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.

Although this definition eliminates the 2013 Guidance's requirement that the employees negotiating and agreeing to the terms of the swap be located in a foreign branch of the U.S. bank, the CFTC noted in the preamble that to satisfy the "normal course of business" prong, it would expect swaps that are booked in the foreign branch to be primarily entered into by personnel located a foreign branch, but that under those circumstances, this requirement would not prevent personnel of the U.S. bank located in the U.S. from participating in the negotiation or execution of such swap. This highly ambiguous guidance is likely to raise concerns for many U.S. banks and their counterparties.

The CFTC also noted that the requirement to make and receive payments through the foreign branch is consistent with the standard ISDA Master Agreement office designation, but as under the current 2013 Guidance, multi-branch ISDA documentation that includes the possibility of booking at a U.S. branch may run afoul of this element of the definition.

(6) U.S. Branch and Swap Conducted Through a U.S. Branch.

The CFTC is proposing new definitions for the terms, "U.S. branch," and "swap conducted through a U.S. branch," which under the Proposed Rules, would be used to identify swap activity that the Commission believes should be considered to take place in the United States and, thus, remain subject to certain CFTC swaps requirements.

Under the Proposed Rules, 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.

The term "swap conducted through a U.S. branch", in turn, 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.

Strangely, the test for whether a swap is conducted through a U.S. branch does not include a "normal course of business" prong like the parallel test for whether a swap is conducted through a foreign branch. Instead, the U.S. branch test seems mostly to focus on booking location.

(7) Foreign-Based Swap and Foreign Counterparty.

The Proposed Rules also includes definitions of "foreign-based swap" and "foreign counterparty,", which, as more fully described below, are used to determine which swaps the Commission considers to be foreign swaps of non-U.S. Swap Entities and foreign branches of U.S. Swap Entities for which certain relief from Commission requirements would be available under the Proposed Rules, and which swaps should be treated as domestic swaps not eligible for such relief.

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.

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.

Given the risk-focused nature of the Proposed Rules, it is unclear why the CFTC thought it necessary to apply additional rules to swaps between a non-U.S. person and the U.S. branch of a non-U.S. bank, given that the risks of such swap are borne entirely by non-U.S. persons.

CROSS-BORDER APPLICATION OF REGISTRATION THRESHOLDS

(1) SD Registration Thresholds

Under existing CFTC rules, the definition of "swap dealer" provides that a person shall not be deemed to be an SD as a result of its swap dealing activity involving counterparties unless, during the preceding 12 months, the aggregate gross notional amount of the swap positions connected with those dealing activities, together with the dealing activity of its affiliates under common control, exceeds the *de minimis* thresholds of $8 billion across all counterparties or $25 million for swaps with counterparties that are pension plans, municipalities, or other Special Entities.

The Proposed Rules address how the *de minimis* thresholds would apply to the cross-border swap dealing transactions of U.S. and non-U.S. persons, which, as discussed below, would depend, in part, on whether the potential registrant is a U.S. person, a Guaranteed Entity, an SRS or a Non-U.S. person other than a Guaranteed Entity or an SRS ("**Other Non-U.S. Person**").

U.S. Person, Guaranteed Entity or SRS. A U.S. person, Guaranteed Entity or SRS would count all of its swap dealing transactions toward its *de minimis* threshold calculation, including dealing swaps entered into by a foreign branch of such person (although, as noted above, a non-U.S. person is only considered a Guaranteed Entity with respect to its swaps that are guaranteed by U.S. persons).

Other Non-U.S. Person. An Other Non-U.S. Person would be required to count toward its *de minimis* threshold calculation:

(1) dealing swaps with a U.S. person, except for swaps conducted through a foreign branch of a registered SD, and

(2) dealing swaps with a Guaranteed Entity, except when (a) the Guaranteed Entity is registered as an SD or (b) the Guaranteed Entity's swaps are subject to a guarantee by a U.S. person that is a non-financial entity.

Provided however, that an Other Non-U.S. Person would not be required to count toward its *de minimis* thresholds any swap cleared through a registered or exempt derivatives clearing organization that the Other Non-U.S. Person anonymously enters into on (A) a designated contract market, (B) a registered or exempted swap execution facility, or (C) a registered foreign board of trade (an "**Anonymous Cleared Swap**").

> The Proposed Rules generally track the *de minimis* counting conventions currently applicable under the 2013 Guidance, although the Proposed Rules would eliminate an existing exception from counting for an Other Non-U.S. Person for transactions with a guaranteed or conduit affiliate that is not a swap dealer and itself engages in *de minimis* swap dealing activity and which is affiliated with a swap dealer. The elimination of this exception could pose issues for some U.S. banking groups, as it might deter Other Non-U.S. Persons from transacting with Guaranteed Entities within those groups that are operating below the *de minimis* thresholds or are in the process of registering as swap dealers.
>
> In addition, it is unclear why the exception for Anonymous Cleared Swaps requires the clearing organization and trading venue to be registered or exempt from registration with the CFTC given that such an organization or venue generally would not trigger registration with the CFTC in the first place if it only admitted Guaranteed Entities and Other Non-U.S. Persons.

For a table prepared by the CFTC summarizing the cross-border application of the SD *de minimis* threshold, see Appendix B.

(2) MSP Registration Thresholds

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. In accordance with the Dodd-Frank Act and CEA section 1a(33)(B), the Commission adopted rules further defining "major swap participant" and providing that a person would not be deemed an MSP unless its swap positions exceed one of several thresholds. The Commission also adopted interpretive guidance stating that, for purposes of the MSP analysis, an entity's swap

positions would be attributable to a parent, other affiliate or guarantor to the extent that the counterparty has recourse to the parent, other affiliate or guarantor and the parent or guarantor is not subject to capital regulation by the Commission, SEC or a prudential regulator ("attribution requirement").

The Proposed Rules identify when a potential MSP's cross-border swap positions would apply toward the MSP thresholds. As discussed below, whether a potential registrant would include a particular swap in its MSP calculation would depend in part on whether the potential registrant is a U.S. person, a Guaranteed Entity, an SRS or an Other Non-U.S. Person.

U.S. Person, Guaranteed Entity or SRS. A U.S. person, Guaranteed Entity or SRS would count all of its swap positions toward its MSP threshold calculation, including swaps entered into by a foreign branch of such person (although, as noted above, a non-U.S. person is only considered a Guaranteed Entity with respect to its swaps that are guaranteed by U.S. persons).

Other Non-U.S. Person. An Other Non-U.S. Person would be required to count toward its MSP threshold:

(1) swap positions with a U.S. person, except for swaps conducted through a foreign branch of a registered SD; and

(2) swap positions with a Guaranteed Entity, except when the Guaranteed Entity is registered as an SD.

Provided however, that an Other Non-U.S. Person would not be required to count toward its MSP threshold any Anonymous Cleared Swap.

The 2013 Guidance extended the exception from the attribution requirement under CFTC Rules for entities subject to U.S. capital regulation to include 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 standards and oversight by a G20 prudential supervisor). The Proposed Rule would eliminate this exception, but the CFTC requested comment on whether that exception would be appropriate to include.

For a table prepared by the CFTC summarizing the cross-border application of the MSP threshold, see Appendix C.

ANE TRANSACTIONS

As noted above, Advisory 13-69 provided that a non-U.S. SD would generally be required to comply with transaction-level requirements for ANE Transactions. The CFTC Staff provided no-action relief from most aspects of Advisory 13-69, which has remained in place pending finalization of further rules or guidance clarifying the scope of CFTC requirements applicable to ANE Transactions.

The Proposed Rules would effectively eliminate Advisory 13-69, and would treat ANE Transactions in the same manner as any other transaction between non-U.S. persons. In adopting the Proposed Rules, the CFTC emphasized that 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.[18] Secondly, the CFTC expects 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.

If adopted, the Proposed Rules would supersede Advisory 13-69 with respect to those requirements covered by the Proposed Rules. However, certain other requirements—mandatory clearing, mandatory trade execution, and real-time public reporting—would remain subject to Advisory 13-69 and related no-action relief pending further CFTC action (unless the CFTC withdrew Advisory 13-69 in its entirety at the same time it finalized the Proposed Rules).

[18] See CEA Section 6(c)(1); CFTC Regulation 180.1.

The SEC, on the other hand, applies a more expansive approach to regulation of ANE Transactions, and its security-based swap rules, subject to certain exceptions, count ANE Transactions towards applicable dealer registration thresholds and applies certain security-based swap requirements to ANE Transactions.

CATEGORIZATION AND APPLICATION OF REQUIREMENTS

(1) Background

The 2013 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 to the individual swap or trading relationship ("**Transaction-Level Requirement**"), with two subcategories of requirements for both Transaction-Level Requirements ("Category A" and "Category B") and Entity-Level Requirements ("Category 1" and "Category 2").

The CFTC has proposed to adopt a similar approach to categorization of certain swap dealer requirements which would be newly designated as Group A, B and C requirements.

The Commission noted in the preamble that it intends to separately address the cross-border application of the Title VII requirements addressed in the 2013 Guidance that are not categorized as Group A, B or C requirements in the Proposed Rules (*e.g.*, capital adequacy, clearing and swap processing, mandatory trade execution, swap data repository reporting, large trader reporting, and real-time public reporting).

(2) Group A Requirements

The proposed Group A requirements would consist of: (1) chief compliance officer (CFTC Rule 3.3); (2) risk management (including requirements of internal policies and procedures to address risk management (CFTC Rules 23.600 and 23.609), monitor compliance with position limits (CFTC Rule 23.601), prevent conflicts of interest (CFTC Rule 23.605), promote diligent supervision (CFTC Rule 23.602), maintain business continuity and disaster recovery programs (CFTC Rule 23.603) and maintain information availability (CFTC Rule 23.606)); (3) swap data recordkeeping (CFTC Rules 23.201 and 23.203); and (4) antitrust considerations (CFTC Rule 23.607). Group A requirements would apply on an entity-wide basis for all swaps, regardless of the U.S. or non-U.S. status of the counterparty.

Consistent with the general approach to Entity-Level Requirements under CFTC rules, the Proposed Rules would permit a non-U.S. Swap Entity to avail itself of substituted compliance with respect to the Group A requirements where the non-U.S Swap Entity is subject to comparable regulation in its home jurisdiction.

Group A requirements track certain of the current Category 1 and 2 Entity-Level Requirements, with the addition of antitrust considerations (which was not categorized under the 2013 guidance) and the removal of capital and reporting requirements (which as noted above will be treated separately). As under the 2013 Guidance, the general recordkeeping requirement regarding retention and production of records under CFTC Rule 1.31 is not explicitly categorized as a Group A requirement, and so its treatment is not entirely clear (even though logically it should be treated like the swap dealer record retention rule, CFTC Rule 23.203, which incorporates it by reference).

(3) Group B Requirements

The group B requirements would consist of: (1) swap trading relationship documentation (CFTC Rule 23.504); (2) portfolio reconciliation and compression (CFTC Rules 23.502 and 23.503); (3) trade confirmation (CFTC Rule 23.501); and (4) daily trading records (CFTC Rule 23.202).

Group B requirements track a subset of the current Category A Transaction-Level Requirements related to risk mitigation and recordkeeping.

Group B requirements would not apply to an Other Non-U.S. Person SD with respect to a foreign-based swap with an Other Non-U.S. Person.

Group B requirements would also not apply to a foreign branch of a U.S. Swap Entity with respect to a foreign-based swap with an Other Non-U.S. Person, subject to the following conditions:

(1) the exception would not be available with respect to any Group B requirement for which substituted compliance 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.

The foreign branch exclusion is designed to replace the emerging markets exception from the 2013 Guidance, but would adopt a more flexible approach. The 2013 Guidance identified particular jurisdictions as ineligible for relief, whereas the Proposed Rules would look to specific CFTC requirements and availability of substituted compliance to determine eligibility with respect to those specific requirements.

If finalized, the existing emerging markets exception should still be relevant with respect to those Transaction-Level Requirements not included in Category B or C. In this regard, the CFTC specifically noted in the Proposed Rules that "the Proposed Rules would not supersede the Commission's policy views as stated in the [2013] Guidance or elsewhere with respect to any other matters."

Separately, Group B requirements (other than pre-execution recordkeeping requirements under the daily trading records) would not apply to an Anonymous Cleared Swap.

With respect to the Group B requirements, which can be effectively applied on a transaction-by-transaction basis, the Commission is proposing to allow a non-U.S. Swap Entity (unless transacting though a U.S. branch), or a U.S. Swap Entity transacting through a foreign branch, to avail itself of substituted compliance with respect to the Group B requirements for swaps with foreign counterparties.

The Proposed Rules' treatment of these requirements for substituted compliance purposes would track the 2013 Guidance except that it would eliminate the possibility for substituted compliance by a non-U.S. Swap Entity transacting through its U.S. branch.

For a table prepared by the CFTC summarizing the cross-border application of the Group B requirements in consideration of related exceptions and substituted compliance, see Appendix D.

(4) Group C Requirements

The Group C requirements would consist of the external business conduct requirements (CFTC Rules 23.400-23.451). They would not apply to a non-U.S. Swap Entity or foreign branch of a U.S. Swap Entity with respect to its foreign-based swaps with foreign counterparties. Group C requirements would also not apply to an Anonymous Cleared Swap.

Group C requirements would not be eligible for substituted compliance. Group C requirements track the current Category B Transaction-Level requirements, and would generally apply in a manner consistent with the 2013 Guidance, except that swaps conducted through a U.S. branch of a non-U.S. Swap Entity would be subject to the requirements, even when the counterparty is a non-U.S. person.

For a table prepared by the CFTC summarizing the cross-border application of the Group C requirements in consideration of related exceptions, see Appendix E.

COMPARABILITY DETERMINATIONS

The CFTC is proposing a comparability determination process, as described below, in connection with the Proposed Rules to permit a non-U.S. Swap Entity or foreign branch of a U.S. Swap Entity to comply with comparable foreign swap standards in lieu of the CFTC's requirements in certain cases.

The CFTC made clear that the Proposed Rules, if adopted, are not intended to affect the effectiveness of any existing CFTC comparability determinations.

(1) Standard of Review

Under the Proposed Rules, in assessing comparability, the CFTC would follow a flexible outcomes-based standard of review and may consider any factor it deems appropriate, such as (1) the scope and objectives of the relevant foreign jurisdiction's regulatory standards, (2) whether a foreign jurisdiction's regulatory standards achieve comparable regulatory outcomes to the CFTC's corresponding requirements, (3) the ability of the relevant regulatory authority to supervise and enforce compliance and (4) whether the relevant foreign jurisdiction's regulatory authorities have entered into a memorandum of understanding or similar cooperative arrangement with the CFTC regarding the oversight of Swap Entities.

The 2013 Guidance similarly adopted an outcomes-based approach, but also looks to whether a particular category of foreign regulatory requirement(s) is comparable and comprehensive to the applicable requirement(s) under the CEA. Notably, the Proposed Rules would not expressly incorporate certain factors addressing comprehensiveness of foreign regulations from the 2013 Guidance, including comprehensiveness of the foreign requirement(s), and the comprehensiveness of the foreign regulator's supervisory compliance program. Additionally, The CFTC stated in the preamble to the Proposed Rules that it would consider whether a foreign regulatory authority has issued a reciprocal comparability determination with respect to the CFTC's corresponding regulatory requirements.

(2) Eligibility Requirements

Under the Proposed Rules, a comparability determination may be initiated by the CFTC on its own or requested by (1) Swap Entities 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.

(3) Submission Requirements

Under the Proposed Rules, any person requesting a comparability determination would be required to furnish certain information to the CFTC that provides a comprehensive understanding of the foreign jurisdiction's relevant swap standards and an explanation as to how such standards may achieve comparable outcomes to the CFTC attendant regulatory requirements.

RECORDKEEPING

Under the Proposed Rules, a Swap Entity would be required to create a sufficiently detailed record of its compliance with the Proposed Rules, and retain those records in accordance with § 23.203.

The CFTC notes in the preamble the importance of the recordkeeping requirement in connection with an entity's compliance program, as well as the Commission's oversight function. If adopted, the maintenance and condition of such records will be a key area of focus in the context of examinations and potential for enforcement.

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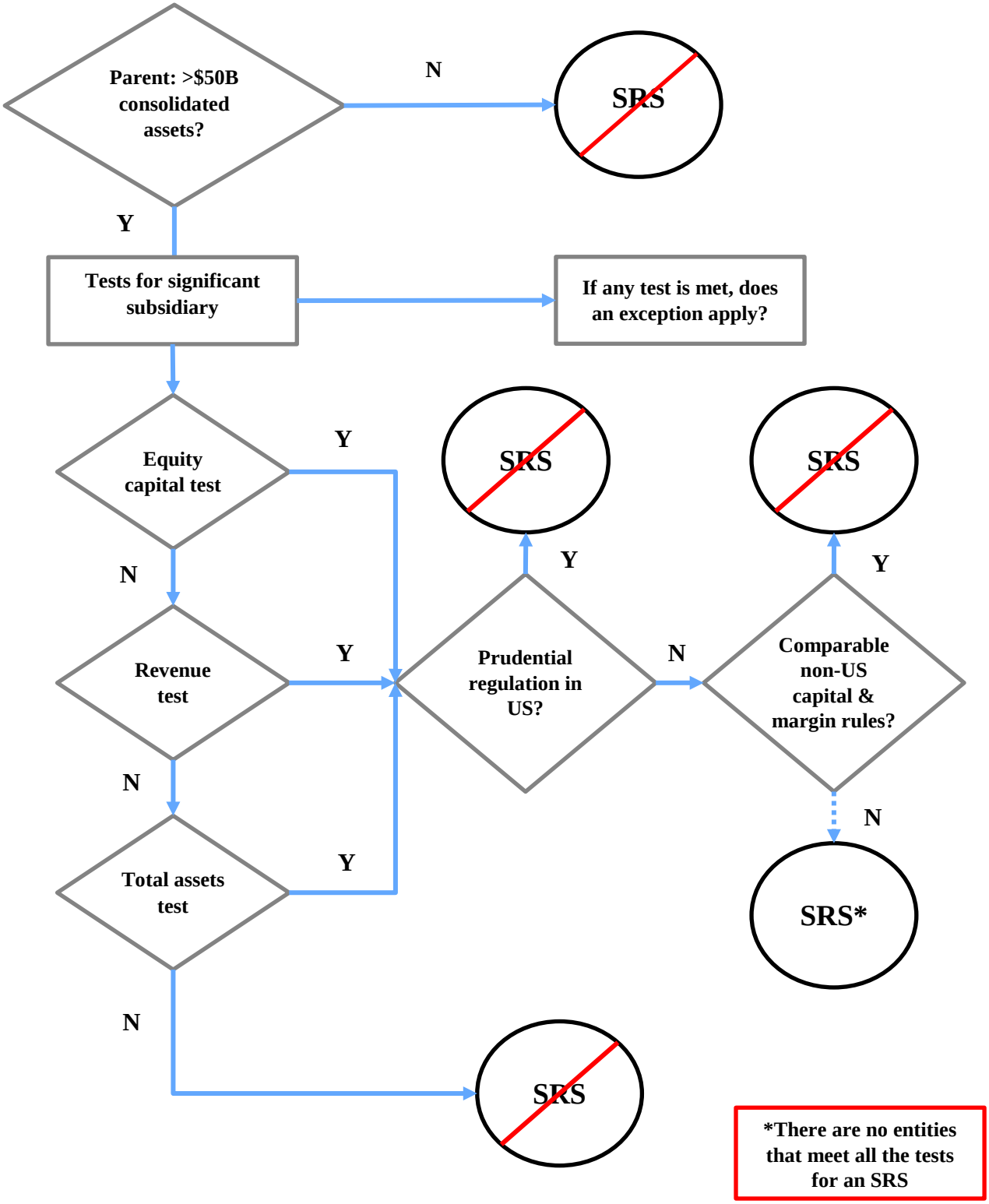
CLEARY GOTTLIEB

APPENDIX A

Tests for Significant Risk Subsidiary (SRS)



APPENDIX B

Cross-Border Application of the SD De Minimis Threshold

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

[1] Would not include swaps entered into anonymously on a DCM, a registered SEF or a SEF exempted from registration, or a registered FBOT and cleared through a registered DCO or a DCO exempted from registration.

[2] Unless the swap is conducted through a foreign branch of a registered SD.

[3] Unless the Guaranteed Entity is registered as an SD, or unless the guarantor is a non-financial entity.

APPENDIX C

Cross-Border Application of the MSP Threshold

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

[1] Would not include swaps 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.

APPENDIX D

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

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

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

[2] Under the Proposed Rules the Foreign Branch Group B Exception would be available from the group B requirements for a foreign branch's foreign-based swaps with a foreign counterparty that is an Other Non-U.S. Person.

APPENDIX E

Cross-Border Application of the Group C Requirements in Consideration of Related Exceptions

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

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