COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1 and 23

RIN 3038–AE54

Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants

AGENCY: Commodity Futures Trading Commission.

ACTION: Proposed rule; interpretations.

SUMMARY: The Commodity Futures Trading Commission (''Commission'' or ''CFTC'') is publishing for public comment proposed rules and interpretations (''Proposed Rule'') addressing the cross-border application of certain swap provisions of the Commodity Exchange Act (''CEA''). Specifically, the proposed rule defines key terms for purposes of applying the CEA's swap provisions to cross-border transactions and addresses the cross-border application of the registration thresholds and external business conduct standards for swap dealers and major swap participants, including the extent to which they would apply to swap transactions that are arranged, negotiated, or executed using personnel located in the United States.

DATES: Comments must be received on or before December 19, 2016.

ADDRESSES: You may submit comments, identified by RIN number 3038–AE54, by any of the following methods:

- *CFTC Web site: http://comments.cftc.gov.* Follow the instructions for submitting comments through the Comments Online process on the Web site.
- *Mail:* Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW., Washington, DC 20581.
- *Hand Delivery/Courier:* Same as Mail, above.
- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.

Please submit your comments using only one method.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to *http://www.cftc.gov.* You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act (''FOIA''), a petition for confidential treatment of the exempt information may be submitted according to the procedures established in § 145.9 of the CFTC's regulations, 17 CFR 145.9.

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

FOR FURTHER INFORMATION CONTACT: Paul Schlichting, Assistant General Counsel, (202) 418–5884, *pschlichting@cftc.gov;* Laura B. Badian, Assistant General Counsel, (202) 418–5969, *lbadian@cftc.gov;* or Elise Bruntel, Counsel, (202) 418–5577, *ebruntel@cftc.gov;* Office of the General Counsel, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW., Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

Table of Contents

I. Background

A. Scope of Rulemaking

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (''Dodd-Frank Act'' or ''Dodd-Frank'') [1] amended the Commodity Exchange Act (''CEA'') [2] to establish a new regulatory framework for swaps. Added in the wake of the 2008 financial crisis, which highlighted the potential for cross-border swap activities to have a substantial impact on the U.S. financial system, the new swap provisions expressly apply to activities that have a direct and significant connection with activities in, or effect on, U.S. commerce or that contravene Commission rules or regulations necessary or appropriate to prevent evasion.[3]

In response to requests from market participants, the Commission published

[1] Public Law 111–203, 124 Stat. 1376 (2010).

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

[3] *See* 7 U.S.C. 2(i). Section 2(i) of the CEA states that the provisions of that chapter relating to swaps that were enacted by the Wall Street Transparency and Accountability Act of 2010 (including any rule prescribed or regulation promulgated under that Act) 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, commerce of the United States; or (2) 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 that chapter that was enacted by the Wall Street Transparency and Accountability Act of 2010.

a policy statement and interpretive guidance regarding the cross-border application of the swap provisions of the CEA.[4] The Guidance offered an interpretation of the term ''U.S. person'' and a general, non-binding framework for the cross-border application of many substantive Dodd-Frank requirements, including requirements for swap dealers (''SDs'') and major swap participants (''MSPs'') (collectively, ''SD/MSPs''). Given the complex and dynamic nature of the global swap market, the Guidance was intended as a flexible and efficient way to provide the Commission's views on cross-border issues raised by commenters, allowing the Commission to adapt in response to changes in the global regulatory and market landscape.[5] The Commission accordingly stated that it would review and modify its cross-border policies as the global swaps market continues to evolve and consider codifying the cross-border application of Dodd-Frank swap provisions in future rulemakings, as appropriate.[6]

In this release, the Commission is proposing to codify a central element of the Dodd-Frank regulatory framework for SDs and MSPs, incorporating various aspects of the Commission's recent cross-border rulemaking regarding the margin requirement,[7] including the definitions of ''U.S. person'' and ''guarantee'' and the concept of a Foreign Consolidated Subsidiary (''FCS''). Specifically, the Proposed Rule addresses when U.S. and non-U.S. persons, including FCSs and those whose swap obligations are guaranteed by a U.S. person, would be required to include their cross-border swap dealing transactions or swap positions in their SD or MSP registration threshold calculations, respectively,[8] and the extent to which SD/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.[9]

The Proposed Rule also addresses issues related to a Commission request for comment on a 2013 staff advisory, which discussed the staff's view of the application of certain Dodd-Frank swap provisions to non-U.S. SDs if they use personnel located in the United States.[10] Specifically, the Proposed Rule addresses situations in which swap transactions are arranged, negotiated, or executed using personnel located in the United States (''ANE transactions''), including the types of activities that would fall within the scope of ANE transactions and the extent to which the SD registration threshold and external business conduct standards apply to ANE transactions.

As part of the proposed rule, the Commission is also proposing to define the key terms of ''U.S. person'' and ''Foreign Consolidated Subsidiary'' for broad cross-border application in a manner consistent with how the terms were defined in the Cross-Border Margin Rule.[11] If adopted, the Commission intends that these definitions would be relevant not only within the context of the proposed rule, but for purposes of any subsequent rulemakings specifically addressing the cross-border application of other substantive Dodd-Frank requirements, unless the context or a specific rule or regulation otherwise requires. The Commission believes that applying a single definition for these terms throughout the Commission's cross-border framework going forward would benefit market participants by eliminating complexity associated with the use of different definitions for different Dodd-Frank rules.

The Proposed Rule does not address the cross-border application of any substantive Dodd-Frank requirements beyond the SD/MSP registration thresholds and external business conduct standards. The Commission expects to address the cross-border application of other Dodd-Frank requirements, including the availability of substituted compliance, in subsequent rulemakings.

B. Current Market Structure

In determining how the Commission's SD/MSP registration thresholds should apply to market participants in cross-border transactions and the extent to which the Dodd-Frank swap requirements should apply to ANE transactions, the Commission was informed by its understanding of the current market practices of global financial institutions. Financial groups that are active in the swap market typically operate in multiple market centers[12] and carry out swap activity with counterparties around the world using a number of different operational structures. A financial group's business model, including its booking practices and how it carries out market-facing activities, reflects a range of business and regulatory considerations, which are weighed differently by, and have different effects on, each group.

Despite its geographic expanse, a global financial group 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. While each branch or affiliate may serve a unique purpose, they are highly interdependent and inextricably linked, with affiliated entities within the corporate group providing financial or credit support for each other, such as in the form of a guarantee or the ability to transfer risk through inter-affiliate trades.[13]

A financial group may reflect all of its swaps in the financial statements of one entity (the ''booking entity''), realizing netting and operational benefits, a practice referred to as ''central booking.'' In this case, the booking entity retains all the risk associated with

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

[5] *Id.* at 45297, n.39.

[6] *See id.* The Commission notes that at the time that the Guidance was adopted, it was tasked with regulating a market that grew to a global scale without any meaningful regulation. Developing a regulatory framework to fit that market is necessarily an iterative process, one that requires adapting and responding to rapid and continual changes in the market. Therefore, the Commission expects that this proposed rulemaking will be followed by additional rulemakings affecting the cross-border application of the Commission's swap regulations.

[7] *See* 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) (''Cross-Border Margin Rule'').

[8] *See* proposed rule § 1.3(ggg)(7) and 1.3(nnn). The SD and MSP registration thresholds are codified at 17 CFR 1.3(ggg)(4) and 1.3(hhh) through (mmm), respectively.

[9] *See* proposed rule § 23.452. The Commission's external business conduct standards are codified in 17 CFR part 23, subpart H (17 CFR 23.400 through 23.451).

[10] *See* Request for Comment on Application of Commission Regulations to Swaps Between Non-U.S. Swap Dealers and Non-U.S. Counterparties Involving Personnel or Agents of the Non-U.S. Swap Dealers Located in the United States, 79 FR 1347 (Jan. 8, 2014) (''Request for Comment''); CFTC Staff Advisory No. 13–69, Applicability of Transaction-Level Requirements to Activity in the United States (Nov. 14, 2013) (''Staff Advisory''), available at *http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/13-69.pdf.* As stated therein, the Staff Advisory represented the views of the Division of Swap Dealer and Intermediary Oversight (''DSIO'') only, and not necessarily those of the Commission or any other office or division thereof. *Id.* at 2.

[11] *See* proposed rule § 1.3(aaaaa); Cross-Border Margin Rule, 81 FR 34818; 17 CFR 23.160(a).

[12] Data from swap data repositories (''SDR data'') indicate that the global swap market has several market centers, including New York, London, and Tokyo.

[13] Even in the absence of an explicit arrangement or guarantee, the parent entity may, for reputational or other reasons, choose or be compelled to assume the risk incurred by its affiliates, branches, or offices located overseas.

each swap, creating one swap portfolio. Alternatively, a financial group may book swaps in several different affiliates depending on the jurisdiction where the counterparty is located or, alternatively, where the financial group manages a particular type of risk or product. In the latter case, the swaps will be reflected in the financial statements of different affiliates. The risks related to the swaps, however, may not remain in the entity in which the swap is booked. Using arrangements such as inter-affiliate transactions or assignments, the risks related to a swap may be transferred to different entities within an affiliated group while the entity at which the swap is booked remains unchanged.[14]

Regardless of a financial group's booking practices, it typically engages in sales or trading functions in one or more market centers. Performing sales and trading functions in global market centers provides the financial group with access to counterparties in that jurisdiction. The financial group's presence in a particular market center also enables the group to more effectively engage in swaps in that locale on behalf of affiliates in other jurisdictions that are servicing counterparties in those jurisdictions.[15]

In this highly-integrated corporate structure, where financial groups engage in swap dealing activity with counterparties located in multiple jurisdictions, it is not uncommon for a swap to be traded through an affiliate in one jurisdiction (the ''market-facing affiliate'') and booked and risk-managed in another (the ''booking affiliate''). In such cases, a particular affiliate may become the market-facing affiliate because its trading desk has expertise in relevant products or because it has an established client network in the relevant jurisdiction or market hub.[16] However, although each affiliate carries out a distinct function in a given swap transaction, together they operate as an integrated dealing business.

Large U.S. financial services firms emphasize the importance of operating globally through a unified structure. For example, Goldman Sachs explains that one of its core businesses ''serves our clients who come to the firm to buy and sell financial products, raise funding and manage risk. We do this by acting as a market maker and offering market expertise on a global basis . . . . Through our global sales force, we maintain relationships with our clients, receiving orders and distributing investment research, trading ideas, market information and analysis. As a market maker, we provide prices to clients globally across thousands of products in all major asset classes and markets . . . . Much of this connectivity between the firm and its clients is maintained on technology platforms and operates globally wherever and whenever markets are open for trading.'' [17] Morgan Stanley explains that it provides financial services to clients globally, primarily through subsidiaries incorporated in the U.S., Europe and Asia, and it ''trades, invests and makes markets globally in listed swaps and futures and OTC cleared and uncleared swaps, forwards, options and other derivatives . . . .'' [18] Citigroup, one of the largest U.S. bank holding companies, describes its global presence as ''trading desks in over 30 countries and market access in 70 countries.'' [19] Citigroup also states that it manages its risk exposures from its activities across all these countries via its ''Centralized Risk Desk.'' [20]

In sum, the current swap market is global in scale and characterized by a high level of interconnectedness among market participants, with transactions negotiated, executed, and arranged between counterparties in different jurisdictions, (and booked and managed in still other jurisdictions). These market realities suggest that a cross-border framework that focuses only on the domicile of the market participant or location of counterparty risk would fail to effectively advance the policy objectives of the Dodd-Frank swap reforms, which were aimed at increasing market transparency and counterparty protections and mitigating the risk of financial contagion in the swap market.[21] At the same time, the Commission is also mindful that its policy choices should aim to enhance market efficiency and competition and the overall functioning of the global swap market. Accordingly, as described in detail below, in developing the Proposed Rule the Commission has strived to implement a cross-border framework that would achieve the important goals of the Dodd-Frank Act while mitigating any unnecessary burdens and avoiding disruption to market practices to the extent possible.

II. Definitions

The Commission is proposing to define the key terms of ''U.S. person'' and ''Foreign Consolidated Subsidiary'' for purposes of applying the Dodd-Frank swaps provisions to cross-border transactions. Whether a market participant is a U.S. person or a Foreign Consolidated Subsidiary would, for instance, affect how the SD/MSP registration thresholds apply under the proposed rule.[22] If adopted, these definitions would also be relevant for purposes of any subsequent rulemakings specifically addressing the cross-border application of other substantive Dodd-Frank requirements, unless the context or a specific rule or regulation otherwise requires.

A. U.S. Person

Under the Proposed Rule, a ''U.S. person'' would be defined as follows:

- Any natural person who is a resident of the United States (proposed § 1.3(aaaaa)(5)(i));

[14] The extent to which swap risk may be transferred without changing the booking entity may depend on relevant accounting rules, legal requirements, and other factors. Swap activities may also be carried out through branches located in separate jurisdictions rather than, or in addition to, affiliates that are domiciled in separate jurisdictions.

[15] From discussions with market participants, the Commission understands that financial groups typically prefer to operate their swap businesses and manage swap portfolios in the jurisdiction where the swap and the underlying asset 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, permitting them to more efficiently price such products or otherwise compete more effectively in the global swap market, including in jurisdictions different from the market center in which the swap is traded.

[16] The market-facing affiliate may in turn employ either its own personnel or the personnel of another affiliate or unaffiliated agent. Market-facing entities may use unaffiliated agents in order to conduct swap dealing activity anonymously or to provide clients with access to market hubs where they do not have their own operations.

[17] *See* The Goldman Sachs Group, Inc. 2013 Annual Report on Form 10–K at 3 (describing Institutional Client Services business, which includes swaps and other derivatives trading), available at *http://www.goldmansachs.com/investor-relations/financials/archived/10k/docs/2013-10-k.pdf.*

[18] *See* Morgan Stanley 2013 Annual Report on Form 10–K at 3, available at *https://www.morganstanley.com/about-us-ir/shareholder/10k2013/10k2013.pdf.*

[19] *See Global Equities,* Citigroup, discussion of equities product line (accessed Sept. 29, 2016), available at *http://www.citibank.com/icg/global_markets/product_solutions/global_equities/index.jsp.* While this description is in the context of equities trading and not necessarily swaps, it illustrates the integrated nature of the global operations of these firms and their affiliates and subsidiaries in different countries.

[20] *See id.*

[21] Nor would such a framework be consistent with CEA section 2(i), which provides that Dodd-Frank's swap provisions and the Commission's regulations thereunder apply to cross-border transactions under certain circumstances. *See Secs. Indus. & Fin. Mkts. Ass'n* v. *CFTC,* 67 F. Supp. 3d 373, 425–26 & n.35 (D.D.C. 2014).

[22] Consistent with the reliance standard articulated in the Commission's external business conduct rules, *see* 17 CFR 23.402(d), market participants would be allowed to reasonably rely on counterparty representations with respect to each of these definitions unless they have information that would cause a reasonable person to question the accuracy of the representation.

- Any estate of a decedent who was a resident of the United States at the time of death (proposed § 1.3(aaaaa)(5)(ii));
- Any 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 proposed paragraph (aaaaa)(5)(iv) or (v) of § 1.3) (''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 the legal entity [23] (proposed § 1.3(aaaaa)(5)(iii));
- Any pension plan for the employees, officers or principals of a legal entity described in proposed paragraph (aaaaa)(5)(iii) of § 1.3, unless the pension plan is primarily for foreign employees of such entity (proposed § 1.3(aaaaa)(5)(iv));
- Any trust governed by the laws of a state or other jurisdiction in the United States, if a court within the United States is able to exercise primary supervision over the administration of the trust (proposed § 1.3(aaaaa)(5)(v));
- Any legal entity (other than a limited liability company, limited liability partnership or similar entity where all of the owners of the entity have limited liability) that is owned by one or more persons described in proposed paragraphs (aaaaa)(5)(i) through (v) of § 1.3 who bear(s) unlimited responsibility for the obligations and liabilities of the legal entity, including any branch of the legal entity (proposed § 1.3(aaaaa)(5)(vi)); and
- Any individual account or joint account (discretionary or not) where the beneficial owner (or one of the beneficial owners in the case of a joint account) is a person described in proposed paragraphs (aaaaa)(5)(i) through (vi) of § 1.3 (proposed § 1.3(aaaaa)(5)(vii)).[24]

In line with commenter requests, this definition mirrors the definition of ''U.S. person'' recently adopted in the context of the Cross-Border Margin Rule.[25] As stated therein, the Commission believes that this definition offers a clear, objective basis for determining which individuals or entities should be identified as U.S. persons and that harmonizing with the definition in the Cross-Border Margin Rule is not only appropriate, but will reduce compliance costs for market participants in the long run.

The proposed U.S. person definition is generally consistent with the U.S. person interpretation set forth in the Guidance, with certain exceptions.[26] Notably, the proposed definition does not include a commodity pool, pooled account, investment fund, or other collective investment vehicle that is majority-owned by one or more U.S. persons (''U.S. majority-owned fund prong'').[27] The Commission understands that identifying and tracking a fund's beneficial ownership may pose a significant challenge in certain circumstances. Although the U.S. owners of such funds may be adversely impacted in the event of a counterparty default, the Commission believes that, on balance, the majority-ownership test should not be included in the definition of U.S. person.[28] In the interest of providing legal certainty, the proposed definition also does not include a catchall provision, thereby limiting the definition of ''U.S. person'' to persons enumerated in the rule.[29]

Finally, consistent with the Cross-Border Margin Rule, paragraph (vi) of the proposed U.S. person definition includes legal entities where one or more U.S. person owner(s) bear unlimited responsibility for the obligations and liabilities of the legal entity (''unlimited U.S. responsibility prong''). This paragraph represents a modified version of a similar concept from the Guidance, which interpreted ''U.S. person'' to include a legal entity ''directly or indirectly majority-owned'' by one or more U.S. person(s) that bear unlimited responsibility for the legal entity's liabilities and obligations.[30] Upon further consideration, the Commission believes that the amount of equity the U.S. owner(s) have in this legal entity would not be relevant because the U.S. person owner(s), by definition, serve as a financial backstop for all of the legal entity's obligations and liabilities regardless of whether they are majority or minority owners.[31]

In consideration of principles of international comity, the Commission proposes that the term ''U.S. person'' would not include international financial institutions. Consistent with Commission precedent,[32] the Commission interprets ''international financial institutions'' to include ''international financial institutions'' as defined in 22 U.S.C. 262r(c)(2) and institutions defined as ''multilateral development banks'' in the Proposal for the Regulation of the European Parliament and of the Council on OTC Derivative Transactions, Central Counterparties and Trade Repositories, Council of the European Union Final Compromise Text, Article 1(4a(a)) (March 19, 2012).[33]

[23] The Commission notes that the reference in proposed § 1.3(aaaaa)(5)(iii) and (vi) (indicating that legal entities would include any branch of the legal entity) is intended to make clear that the definition includes both foreign and U.S. branches of an entity. The Commission further notes that a branch does not have a legal identity apart from its principal entity. The proposed language is not intended to introduce any additional criteria for determining an entity's U.S. person status.

[24] *See* proposed rule § 1.3(aaaaa)(5). *See also* proposed rule § 1.3(aaaaa)(2) (defining ''non-U.S. person'' as any person that is not a U.S. person); 17 CFR 23.160(a)(10) (defining U.S. person for purposes of the Cross-Border Margin Rule). The Commission notes that an affiliate or a subsidiary of a U.S. person that is organized or incorporated in a non-U.S. jurisdiction would not be deemed a U.S. person solely by virtue of its affiliation with a U.S. person. As used herein, the term ''U.S. counterparty'' refers to a swap counterparty that is a ''U.S. person'' under the Proposed Rule.

[25] *See* 17 CFR 23.160(a)(10). *See also* Cross-Border Margin Rule, 81 FR at 34823–24. Unless expressly stated otherwise herein, the description of the U.S. person definition in the Cross-Border Margin Rule, including the Commission's interpretation of the principal place of business test regarding funds, would also apply in the context of the Proposed Rule.

[26] *See* Guidance, 78 FR at 45308–17 (setting forth the interpretation of ''U.S. person'' for purposes of the Guidance).

[27] *See id.* at 45313–14 (discussing the U.S. majority-ownership prong for purposes of the Guidance). The Guidance interpreted ''majority-owned'' in this context to mean the beneficial ownership of more than 50 percent of the equity or voting interests in the collective investment vehicle. *See id.* at 45314.

[28] Note that a fund fitting within the majority U.S. ownership prong may also be a U.S. person within the scope of paragraph (iii) of the Proposed Rule (entities organized or having a principal place of business in the United States). As the Commission clarified in the Cross-Border Margin Rule, whether a pool, fund or other collective investment vehicle is publicly offered only to non-U.S. persons and not offered to U.S. persons would not be relevant in determining whether it falls within the scope of the proposed U.S. person definition. *See* Cross-Border Margin Rule, 81 FR at 34824 n.62.

[29] *See* 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).

[30] *See id.* at 45312–13 (discussing the unlimited U.S. responsibility prong for purposes of the Guidance).

[31] *See* Cross-Border Margin Rule, 81 FR at 34823–24.

[32] *See* Guidance, 78 FR at 45353 n.531 (incorporating the interpretation of ''international financial institutions'' included in Further Definition of ''Swap Dealer,'' ''Security-Based Swap Dealer,'' ''Major Swap Participant,'' ''Major Security-Based Swap Participant'' and ''Eligible Contract Participant,'' 77 FR 30596, 30692 n.1180 (May 23, 2012) (''Entities Rule'')).

[33] The two 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

Continued

Request for Comment. The Commission invites comment on all aspects of the Proposed Rule, including on whether and in what respects the Commission should further harmonize the U.S. person definition in the Proposed Rule to either the interpretation of U.S. person included in the Guidance or the U.S. person definition adopted by the Securities Exchange Commission (''SEC'') in rule 3a71–3(a)(4) under the Securities Exchange Act of 1934 (''Exchange Act'').[34]

B. Foreign Consolidated Subsidiary (''FCS'')

Under the Proposed Rule, the term ''Foreign Consolidated Subsidiary'' identifies a non-U.S. person that is consolidated for accounting purposes with an ultimate parent entity that is a U.S. person (a ''U.S. ultimate parent entity''). Consistent with the Cross-Border Margin Rule, the proposed rule would define ''Foreign Consolidated Subsidiary'' to mean 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.[35] The proposed rule would define the term ''ultimate parent entity'' to mean the parent entity in a consolidated group in which none of the other entities in the consolidated group has a controlling interest, in accordance with U.S. GAAP.[36]

The proposed FCS definition offers a clear, bright-line test for identifying non-U.S. persons whose swap activities present a greater supervisory interest relative to other non-U.S. market participants, due to the nature and extent of the FCS's relationship with its U.S. ultimate parent. As described above, the nature of modern finance is such that large financial institutions typically conduct their business operations through a highly integrated network of business lines and services conducted through multinational branches or subsidiaries that are under the control of the ultimate parent entity. Under this structure, U.S. and non-U.S. derivatives trading functions as a single enterprise, using funds, risk management, information systems and trading personnel across the entire consolidated entity in the most efficient manner in effectuating coordinated trading strategies, with the profits and losses from global trading operations aggregated in the consolidated financial statements of the ultimate parent entity. The Commission believes that the FCS definition appropriately encompasses those entities within this consolidated group that are subject to the financial control, and directly impact the financials, of the U.S. ultimate parent entity.

First, consolidation under U.S. GAAP is predicated on the financial control of the reporting entity.[37] 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. Second, as the Commission previously stated, by virtue of consolidation with its parent entity's financial statement under U.S. GAAP, an FCS's swap activity creates direct risk to the U.S. parent.[38] That is, as a result of consolidation, the financial position, operating results, and statement of cash flows of an FCS are included in the financial statements of its U.S. ultimate parent and therefore affect the financial condition, risk profile, and market value of the parent. Because of that relationship, risks taken by FCSs can have a direct effect on the U.S. ultimate parent entity. Furthermore, the FCS's counterparties generally look to both the FCS and its U.S. ultimate parent for fulfillment of the FCS's obligations under the swap, even without any explicit guarantee.[39] In many cases, the Commission believes that the counterparty 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 swaps business, absent this close relationship with the parent entity.

Under these circumstances, the Commission believes that it is appropriate to require FCSs to include relevant swaps for the SD/MSP registration calculation like a U.S. person (and U.S. Guaranteed Entity).[40]

Investment Bank, Caribbean Development Bank, European Investment Bank and European Investment Fund. Note that the International Bank for Reconstruction and Development, the International Finance Corporation and the Multilateral Investment Guarantee Agency are parts of the World Bank Group. The Commission's proposal is generally similar to the position adopted by the SEC, which excluded from its U.S. person definition 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. *See* 17 CFR 240.3a71–3(a)(4)(iii); Application of ''Security-Based Swap Dealer'' and ''Major Security-Based Swap Participant'' Definitions to Cross-Border Security-Based Swap Activities; Republication, 79 FR 47278, 47306 (Aug. 12, 2014) (''SEC Cross-Border Rule'').

[34] Exchange Act rule 3a71–3(a)(4), 17 CFR 240.3a71–3(a)(4), defines ''U.S. person'' to mean any natural person resident in the United States; any 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; any account (whether discretionary or non-discretionary) of a U.S. person; or any estate of a decedent who was a resident of the United States at the time of death.

Exchange Act rule 3a71–3(a)(4) defines ''principal place of business'' to mean the location from which the officers, partners, or managers of the legal person primarily direct, control, and coordinate the activities of the legal person. It also provides that, with respect to an externally managed investment vehicle, this location is the office from which the manager of the vehicle primarily directs, controls, and coordinates the investment activities of the vehicle.

[35] *See* proposed rule § 1.3(aaaaa)(1). *See also* 17 CFR 23.160(a)(1) (defining ''Foreign Consolidated Subsidiary'' for purposes of the Cross-Border Margin Rule). The Cross-Border Margin Rule defined the term ''Foreign Consolidated Subsidiary'' as limited to SDs and MSPs subject to the Commission's margin requirements (''Covered Swap Entities'' or ''CSEs''), using the term to distinguish non-U.S. CSEs with a U.S. ultimate parent entity from other non-U.S. CSEs. 81 FR at 34826–27. The proposed FCS definition similarly but more broadly distinguishes any non-U.S. person that is consolidated with a U.S. ultimate parent entity from other non-U.S. persons, regardless of whether it is a CSE.

[36] *See* proposed rule § 1.3(aaaaa)(3). *See also* 17 CFR 23.160(a)(6) (defining ''ultimate parent entity'' for purposes of the Cross-Border Margin Rule).

[37] There are two consolidation models. First, entities are subjected to the variable interest entity ('VIE') model. If the VIE model is not applicable, then entities are subjected to the voting interest model. Under the VIE model, a reporting entity has a controlling financial interest in a VIE if it has: (a) The power to direct the activities of the VIE that most significantly affect the VIE's economic performance, and (b) the obligation to absorb losses or the right to receive benefits that could be significant to the VIE. Under the voting interest model, a controlling financial interest generally exists if a reporting entity has a majority voting interest in another entity. In certain circumstances, the power to control may exist when one entity holds less than a majority voting interest (*e.g.,* because of contractual provisions or agreements with other shareholders). *See* Financial Accounting Standards Board, Accounting Standards Codification 810, *Consolidation*.

[38] Cross-Border Margin Rule, 88 FR at 34826–27.

[39] As Moody's Ratings states in a description of its bank assessment methodology, ''most [financial] groups can be expected to support banking entities within their consolidation.'' *See* Moody's Investors Service, Cross-Border Application of the Swap Dealer De Minimis Exception (Sept. 9, 2014) at 66, available at *https://www.moodys.com/microsites/gbrm2014/RFC.pdf*.

[40] The Commission notes that there are some important differences between a U.S. Guaranteed Entity and an FCS. *See* Cross-Border Margin Rule, 81 FR at 34827 (noting that, in contrast to U.S. Guaranteed CSEs, in the event of an FCS's default, the U.S. ultimate parent entity does not have a legal obligation to fulfill the obligations of the FCS. Rather that decision would depend on the business judgment of its parent). *See also supra* note 35 (describing the definition of FCS in the context of the Cross-Border Margin Rule).

A failure to treat these entities the same in this context could provide a U.S. financial group with an opportunity to avoid SD or MSP registration by conducting relevant swap activities through unregistered entities. However, as in the Cross-Border Margin Rule, the Commission would not necessarily treat FCSs the same as a U.S. person (or U.S. Guaranteed Entity) in the context of other Dodd-Frank swap provisions.[41] The Commission also recognizes that other affiliates, even though they are not consolidated with the U.S. ultimate parent entity for accounting purposes, could likewise be distinguished from other non-U.S. persons given the nature of their relationship with the U.S. person and the U.S. market.[42] The Commission believes that the consolidation test provides a workable definition that is tailored to focus on those affiliates that present greater supervisory concerns (relative to other non-U.S. persons).

Request for Comment. The Commission seeks comment on all aspects of the Proposed Rule's definition of ''Foreign Consolidated Subsidiary'' including on whether the proposed FCS definition appropriately captures persons that raise greater supervisory concerns relative to other non-U.S. persons whose swap obligations are not guaranteed by a U.S. person. If not, please explain and provide an alternative(s).

III. ANE Transactions

A. Background

In November 2013, DSIO issued a staff advisory providing that a non-U.S. swap dealer that regularly uses personnel or agents located in the United States to arrange, negotiate, or execute a swap with a non-U.S. person (''Covered Transactions'') would generally be required to comply with the ''Transaction-Level Requirements,'' as the term was used in the Guidance.[43] In January 2014, the Commission published a request for comment on all aspects of the 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; (2) whether the Commission should adopt the Staff Advisory as Commission policy, in whole or in part; and (3) whether substituted compliance should be available for non-U.S. swap dealers with respect to Covered Transactions.[44]

The Commission received seventeen comment letters in response to the Request for Comment.[45] Most commenters challenged the Staff Advisory as inconsistent with CEA section 2(i)[46] or international comity.[47] They emphasized that the risk associated with Covered Transactions lies outside the United States[48] and that non-U.S. swap dealers involve U.S. personnel primarily for the convenience of their global customers.[49] They also characterized the Staff Advisory as impractical or unworkable, describing its key language (''regularly arranging, negotiating, or executing swaps'' and ''performing core, front-office activities'') as vague, open to broad interpretation, and potentially capturing activities that are merely ''incidental'' to the swap transaction.[50] They further argued that if the Staff Advisory were adopted as Commission policy, non-U.S. swap dealers would close U.S. branches and relocate personnel to other countries (or otherwise terminate agency contracts with U.S.-based agents) in order to avoid Dodd-Frank swap regulation or having to interpret and apply the Staff Advisory, thereby increasing market fragmentation.[51]

A few commenters, however, supported the Staff Advisory.[52] They argued that the Commission has jurisdiction over swap activities

---

[41] Although the proposed rule is focused on the cross-border application of the registration thresholds and external business conduct standards for SD/MSPs, the Commission expects to address how other substantive Dodd-Frank swap requirements (including the trading and clearing mandates and reporting requirements) would apply to FCSs in cross-border transactions in subsequent rulemakings. In doing so, the Commission will give due consideration to whether, and the extent to which, substituted compliance should be made available to FCSs' swap transactions.

[42] In particular, the Commission recognizes that, even absent consolidated financial statements, a U.S. parent entity may, for reputational reasons, determine that they must support their non-U.S. affiliates at times of crisis, with direct risk implications for the U.S. parent and U.S. market.

[43] *See supra* note 10. *See also* Guidance, 78 FR at 45333 (providing that the Transaction-Level Requirements include (i) Required clearing and swap processing; (ii) margining (and segregation) for uncleared swaps; (iii) mandatory trade execution; (iv) swap trading relationship documentation; (v) portfolio reconciliation and compression; (vi) real-time public reporting; (vii) trade confirmation; (viii) daily trading records; and (ix) external business conduct standards).

[44] *See* Request for Comment, 79 FR at 1348–49.

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

[46] *See, e.g.,* IAA at 2 n.4; IIB at 4–5 (transactions between two non-U.S. persons present no risk to the U.S. financial system and therefore do not have a ''direct and significant'' nexus to U.S. commerce); ISDA at 3–4, 10–13 (challenging the Commission's interpretation of ''direct and significant''); JFMC at 3; SIFMA/FIA/FSR at A–2–A–3 (section 2(i) should be interpreted in light of the Dodd-Frank goal of mitigating risk); SG at 8. *Accord* European Commission (the Staff Advisory does not clearly articulate how the standard it sets out is consistent with section 2(i)).

[47] *See, e.g.,* European Commission at 2 (the unavailability of substituted compliance would seem to depart from the G20 commitment to defer to foreign regulators when appropriate); IIB at 5–6; ISDA at 8–9; IAA at 4 (failure to grant substituted compliance reflects a lack of coordination with foreign regulators, leading to a less efficient use of regulatory resources and the potential for duplicative or conflicting regulations); JFMC at 3; SIFMA/FIA/FSR at A–13.

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

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

[50] *See, e.g.,* Barclays at 4–5; European Commission at 3 (whether negotiation of a Master Agreement by U.S. middle office staff would trigger application of the Staff Advisory is unclear); IAA at 5 (''[T]he terms 'arranging' and 'negotiating' are overly broad and may encompass activities that are incidental to a swap transaction,'' such as providing market or pricing information); SIFMA/FIA/FSR at A–12 (arranging and negotiating trading relationships and legal documentation are ''middle- and back-office operations'' and should not be included); SG at 7–8 (''regularly'' is an arbitrary concept that cannot be made workable, and programming trading systems to interpret ''arranging, negotiating, or executing'' on a trade-by-trade basis would not be feasible).

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

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

occurring inside the United States [53] and expressed concern that the Commission's failure to assert such jurisdiction would create a substantial loophole, allowing U.S. financial firms to operate in the United States without Dodd-Frank oversight by merely routing swaps through a non-U.S. affiliate.[54] They further argued that arranging, negotiating, or executing swaps are functions normally performed by brokers, traders, and salesperson and are ''economically central to the business of swap dealing.'' [55] They added the focus on the ''regular'' use of personnel located in the United States to perform such core dealing activities would exclude ''entirely incidental'' interactions with U.S. personnel from triggering Dodd-Frank oversight.[56]

Commenters that disagreed with the Staff Advisory nevertheless offered a few suggestions for its modification, should the Commission determine to adopt it, including offering substituted compliance for Covered Transactions [57] or otherwise limiting the scope of applicable requirements.[58] Certain commenters, for instance, recommended that the applicable requirements be limited to pre-trade disclosure requirements (*e.g.,* disclosure of material information), arguing that applying relationship-wide external business conduct rules would require wholesale amendments to relationship documentations even where the specific communication is not material to the overall trading relationship.[59]

B. Commission's Views Regarding ANE Transactions

After considering the views of commenters on the Staff Advisory in response to the Commission's Request for Comment, the Commission is setting forth its views on whether persons engaged in ANE transactions or transactions arising from this activity fall within the scope of the Dodd-Frank Act. The Commission's analysis is guided by the definition of ''swap dealer'' under the CEA and Commission regulations.

Under both the CEA and Commission regulations, whether a person is a ''swap dealer'' is a functional test that focuses on whether the person engages in particular types of activities involving swaps.[60] In general, the swap dealer definition encompasses persons that engage in any of the following types of activity: (1) Holding oneself out as a dealer in swaps; (2) making a market in swaps; (3) regularly entering into swaps with counterparties as an ordinary course of business for one's own account; or (4) engaging in any activity causing oneself to be commonly known in the trade as a dealer or market maker in swaps.[61] Commission regulations further define the term to include specific activities indicative of acting as a swap dealer, such as (1) providing liquidity by accommodating demand for or facilitating interest in the swap, holding oneself out as willing to enter into swaps, or being known in the industry as being available to accommodate demand for swaps; (2) advising a counterparty as to how to use swaps to meet the counterparty's hedging goals, or structuring swaps on behalf of a counterparty; (3) having a regular clientele and actively advertising or soliciting clients in connection with swaps; (4) acting in a market maker capacity on an organized exchange or trading system for swaps, and (5) helping to set the prices offered in the market rather than taking those prices, although the fact that a person regularly takes the market price for its swaps does not foreclose the possibility that the person may be a swap dealer.[62] 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. Consistent with the focus of the ''swap dealer'' definition on a person's activity, the Commission does not believe that the location of counterparty credit risk associated with a dealing swap—which, as discussed above, 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 or whether the Commission has a regulatory interest in the dealing activity. The appropriate inquiry also considers whether a non-U.S. person is engaged in the United States in any of the indicia of dealing activity set forth in the definition of ''swap dealer.''

In the Commission's view, and as further explained below, arranging, negotiating, or executing swaps are functions that fall within the scope of the ''swap dealer'' definition. That the counterparty risks may reside primarily outside the United States is not determinative. To the extent that a person uses personnel located in the United States (whether its own personnel or personnel of an agent) to arrange, negotiate, or execute its swap dealing transactions, the Commission believes that such person is conducting a substantial aspect of its swap dealing activity within the United States and therefore, falls within the scope of the Dodd-Frank Act.

The Commission further believes that to the extent that ANE transactions raise regulatory concerns of the type that the Dodd-Frank Act is intended to address, applying specific Dodd-Frank swap requirements to ANE transactions may be appropriate. In establishing a comprehensive regulatory regime for swaps under the Dodd-Frank Act, Congress intended to advance several

[53] *See* AFR at 2 (CEA section 2(i) clearly sets the statutory jurisdiction of CFTC rules to include all activities conducted inside the United States); Better Markets at 3 (the Staff Advisory ''represents the only reasonable interpretation of Congress's mandate to regulate swaps transactions with a 'direct and significant connection with activities in, or effect on, commerce of the United States'''); IATP at 1 (''It should be self-evident that the swaps activities in the United States of non-U.S. persons fall under the Commission's jurisdiction.'').

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

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

[56] *See* AFR at 2–3, 5 (terms '''arranging, negotiating, or executing' would appear to exclude purely clerical and incidental functions such as notating or recording the sale of a swap for consolidated risk management or bookkeeping purposes''). *See also id.* at 5 (definition of ''regularly'' should be tied to an expectation that U.S. personnel are available on request to arrange, negotiate, and execute swaps).

[57] *See, e.g.,* Coalition at 5; ESMA at 1; IAA at 3–4; ISDA at 9–10; SIFMA/FIA/FSR at A–13, SG at 6–7.

[58] *See, e.g.,* Barclays at 3 n.11 (transaction-level requirements focused on risk mitigation, market integrity, or transparency should not apply to Covered Transactions); Barnard at 2 (transaction-level requirements should not apply to Covered Transactions with non-U.S. counterparties that are not guaranteed or conduit affiliates); IIB at 9–10.

[59] *See, e.g.,* Barclays at 3 (''Applying the pre-trade disclosure requirements promotes the Commission's interests in regulating activities of U.S. based personnel or agents of Commission registered entities and in protecting counterparties. Such concerns may be raised by the activities of such individuals even if the risk arising from those swaps transactions is borne by entities outside the United States.''); IIB at 10–12 (''Non-U.S. counterparties may reasonably expect the protection of the sales practice rules applicable in the jurisdiction of the personnel responsible for committing the non-U.S. swap dealer to the swap.''); SIFMA/FIA/FSR at A–10–A–12 (''[O]nly direct communications by personnel located in the United States with counterparties that commit the SD to the execution of the transaction should trigger application of the requirements under the Staff Advisory.'' (Emphasis omitted)).

[60] *See* 7 U.S.C. 1a(49); 17 CFR 1.3(ggg); Entities Rule, 77 FR at 30598.

[61] *See* Entities Rule, 77 FR at 30597; 7 U.S.C. 1a(49)(A); 17 CFR 1.3(ggg)(1).

[62] *See* Entities Rule, 77 FR at 30608.

fundamental policy objectives, including reducing risk, increasing market transparency and promoting market integrity within the financial system. 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.[63] Even if the financial risks are borne by entities residing outside the United States, this activity indicates a level of involvement, and intention to participate, in the U.S. swap market that may raise concerns regarding customer protection, market transparency and financial contagion intended to be addressed by the Dodd-Frank Act. Accordingly, it would undermine the policy objectives of the Dodd-Frank Act to deem persons that, in connection with their dealing activity, engage in ANE transactions or transactions arising from this activity to fall entirely outside the scope of the Dodd-Frank Act solely because the transactions involve two non-U.S. counterparties.

In making a determination as to whether a particular Dodd-Frank swap requirement (including those specifically applicable to swap dealers) should apply to an ANE transaction, the Commission would consider the extent to which the underlying regulatory objectives would be advanced in light of other policy considerations, including the potential for undue market distortions and international comity. As indicated above, the Proposed Rule addresses the application of the SD registration threshold and external business conduct standards to ANE transactions. The Commission intends to address application of other Dodd-Frank swap requirements to ANE transactions in subsequent cross-border rulemakings as necessary and appropriate.

C. Proposed Interpretation Regarding the Scope of ANE Transactions

For purposes of the proposed rule, the Commission uses the terms ''arrange'' and ''negotiate'' to refer to market-facing activity normally associated with sales and trading, as opposed to internal, back-office activities, such as ministerial or clerical tasks, performed by personnel not involved in the actual sale or trading of the relevant swap.[64] Accordingly, the terms would not encompass activities such as swap processing, preparation of the underlying swap documentation (including negotiation of a master agreement and related documentation), or the mere provision of research information to sales and trading personnel located outside the United States. In line with Commission precedent, ''executed'' would refer to the market-facing act of becoming legally and irrevocably bound to the terms of the transaction under applicable law.[65]

In applying the proposed rule, the Commission would look to the activities of personnel assigned to (on an ongoing or temporary basis) or regularly working in a U.S. location.[66] Such personnel may be working directly for the dealing entity itself or a third-party that is acting for or on behalf of (*i.e.,* as an agent of) the dealing entity, including a U.S. affiliate of the dealing entity. The proposed definition would also include the market-facing activity of personnel normally associated with sales and trading even if the personnel are not formally designated as sales persons or traders. As an anti-evasionary measure, a transaction would be viewed as falling within the scope of the Dodd-Frank Act if personnel located in the United States direct other personnel to arrange, negotiate, or execute the transaction for or on behalf of a dealing entity.

Swap transactions arranged, negotiated, or executed by personnel located in the United States implicate the Commission's supervisory interests regardless of the reason such U.S. personnel were involved. For example, a swap would not fall outside the scope of the Dodd-Frank Act because a counterparty sought to enter into the swap outside of its jurisdiction's regular trading hours. Additionally, the Commission believes permitting such an exception would only incentivize dealing entities to wait until after hours to enter into a swap, creating the potential for a substantial loophole.

Finally, as the SEC noted in its cross-border rulemaking addressing ANE transactions, the Commission would not view a swap as falling outside the scope of the ANE transactions solely as a result of algorithmic trading.[67] That is, a swap transaction involving algorithmic trading could be viewed as having been arranged, negotiated, or executed using personnel located in the United States if such personnel specify the trading strategy or techniques carried out through algorithmic trading or automated electronic execution of swaps.[68] Therefore, performance of such activity by personnel located in the United States may fall within the scope of the Dodd-Frank Act and trigger the application of certain swap requirements thereunder.

The Commission's proposed approach to the determination of when a swap is an ANE transaction reflects its consideration of the comments received in response to the Request for Comment and is generally aligned with the SEC's approach to this determination in the context of security-based swaps.[69] In response to commenters and in the interest of aligning with the SEC, to the extent that the proposed rule applies to ANE transactions, application of the proposed rule would not be limited to swaps ''regularly'' arranged, negotiated, or executed using U.S. personnel. Accordingly, a dealing entity may need to establish operational structures to identify swaps for which relevant personnel performing market-facing activity in connection with the transaction are located in the United States. The Commission believes, however, that the proposed rule's focus on personnel assigned to or regularly working in a U.S. location would exclude incidental activity and mitigate the burden of such an analysis, as the Commission expects that market

[63] As discussed above, the financial group affiliate may use the trading desk of an affiliate that possesses expertise in relevant products or personnel of an affiliate with an established client network in relevant market hubs. The financial group affiliate may also use the personnel of an unaffiliated agent to conduct its swap dealing activity, typically where it is seeking to trade anonymously or to provide clients with access to market hubs where it does not have its own operation.

[64] A swap transaction may be ''arranged'' by personnel located in the United States regardless of whether the counterparty initiated the transaction or whether the counterparty's business was solicited.

[65] *Cf.* 17 CFR 23.200(e) (defining ''execution'' to mean an agreement by the parties (whether orally, in writing, electronically, or otherwise) to the terms of a swap that legally binds the parties to such swap terms under applicable law); 23.200(d) (further defining ''executed'' to mean the completion of the execution process).

[66] The Proposed Rule would accordingly not capture the activities of personnel assigned to a non-U.S. location if such personnel are only incidentally present in the United States when they arrange, negotiate, or execute a transaction (*e.g.,* an employee of a non-U.S. person happens to be traveling within the United States to attend a conference). Nor would the Proposed Rule include a transaction solely on the basis that a U.S.-based attorney is involved in negotiations regarding the terms of the transaction.

[67] *See* Security-Based Swap Transactions Connected With a Non-U.S. Person's Dealing Activity That Are Arranged, Negotiated, or Executed by Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent; Security-Based Swap Dealer De Minimis Exception, 81 FR 8598, 8623 (Feb. 19, 2016) (''SEC ANE Rule''). The Commission would also not view a swap as falling outside the scope of ANE transactions because it resulted from automated electronic execution.

[68] The activities or location of personnel responsible solely for coding the algorithm, however, as opposed to specifying the trading strategy or techniques that the algorithm is to follow, would not be relevant.

[69] *See supra* note 67.

participants have means of identifying personnel involved in market-facing activity, either for regulatory compliance purposes or to facilitate compensation.[70] The Commission further expects that, to the extent that the Proposed Rule applies to ANE transactions, additional burdens on potential SDs could be reduced given that the Commission's proposed approach to determining whether a swap falls within the scope of ANE transactions is substantively identical to the SEC's approach to ANE transactions.[71]

The Commission's treatment of ANE transactions is intended to capture activity that raises a substantial regulatory interest while still promoting a framework that is clear and workable for market participants. By focusing on market-facing activity carried out by personnel located in the United States, the Commission believes its interpretation adequately captures the Commission's inherently strong regulatory interest in dealing activity occurring within its jurisdiction while enabling market participants to apply the definition in a relatively efficient manner.

Request for Comment. The Commission invites comment on all aspects of the Proposed Rule, including the following:

1. The Commission invites comment on whether its interpretation of ANE transactions is appropriately tailored to capture activity that raises a substantial regulatory interest and sufficiently clear and workable for market participants. Is the Commission's focus on and discussion of market-facing activity understandable and effective in excluding activities that are merely incidental to the swap transaction? Will the Commission's interpretation pose any operational challenges? Please explain and provide specific recommendations for modifications or clarifications.

2. Under what other circumstances, if any, should the Commission determine that U.S. personnel are directing a system for the algorithmic trading within the scope of its interpretation of ANE transactions?

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

In accordance with CEA section 1a(49)(D), the Commission has exempted from designation as an SD any entity that engages in a de minimis quantity of swap dealing with or on behalf of its customers.[72] Specifically, Commission regulation 1.3(ggg)(4) provides that a person shall not be deemed to be an SD as a result of its swap dealing activity involving counterparties unless, during the preceding 12 months, the aggregate gross notional amount of the swap positions connected with those dealing activities exceeds the de minimis threshold.[73] Commission regulation 1.3(ggg)(4) further requires that, in determining whether its swap dealing activity exceeds the de minimis threshold, a person must include the aggregate notional value of the swap positions connected with the dealing activities of its affiliates under common control (''aggregation requirement'').[74]

The Commission is now proposing rules to address how the de minimis threshold should apply to the cross-border swap dealing transactions of U.S. and non-U.S. persons.[75] Specifically, the proposed rule identifies when a potential SD's cross-border dealing activities should be included in its de minimis calculation and when they may properly be excluded. As discussed in the sections below, whether a potential SD would include a particular swap in its de minimis calculation would depend on whether the potential SD is classified as either a U.S. person or a non-U.S. person whose obligations under the relevant swap are guaranteed by a U.S. person (''U.S. Guaranteed Entity'') [76] (section A); a Foreign Consolidated Subsidiary (section B); or a non-U.S. person that is neither an FCS nor a U.S. Guaranteed Entity (''Other Non-U.S. Person'') (section C). Section D addresses the cross-border application of the aggregation requirement. Section E provides an overall summary of the Commission's proposed approach. If adopted, the Proposed Rule would supersede the Guidance with respect to the cross-border application of the SD de minimis threshold.

In developing the proposed cross-border approach to applying the SD and MSP registration thresholds,[77] the Commission attempted to target those entities that—due to the nature of their relationship with a U.S. person or U.S. financial market—most directly implicate the purposes of the Dodd-Frank registration scheme. The proposed rule is also designed to apply the registration thresholds in a consistent manner to differing organizational structures that serve similar economic functions so as to avoid creating substantial regulatory loopholes. At the same time, the Commission is mindful of the impact 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 proposed rule reflects a measured approach that advances the goals underlying the SD and MSP registration schemes, consistent with the Commission's

[70] Dealing entities may also facilitate their compliance by establishing appropriate policies and procedures, including by requiring dealing activity to be arranged, negotiated, and executed by personnel located outside the United States.

[71] One commenter on the SEC's proposed approach, which closely tracked its final rule, observed that it created ''a definable standard that will bring clarity to the application of security-based swap requirements to security-based swap dealers, and is appropriate and consistent with the expectations of the parties as to when U.S. security-based swap requirements will apply.'' SIFMA/FSR (SEC July 13, 2015) at 2 (stating also that the commenters ''strongly believe that the Commission has taken the correct approach in focusing on market-facing activity of sales and trading personnel in defining the 'arrange, negotiate, or execute' nexus that subjects security-based swap activity to the Commission's regulations based on location of conduct'').

[72] *See* 7 U.S.C. 1a(49)(D) (directing the Commission to establish a de minimis exception from the SD definition). *See also* 17 CFR 1.3(ggg)(4); Entities Rule, 77 FR 30596.

[73] *See* 17 CFR 1.3(ggg)(4)(i)(A). The de minimis threshold is currently set at a phase-in level of $8 billion, with an ultimate threshold of $3 billion. Pursuant to Commission regulation 1.3(ggg)(4)(ii), following publication of a staff report on the de minimis exception, the Commission may either terminate the phase-in level, and thereby institute the $3 billion threshold, or propose an alternative threshold through rulemaking. *See* 17 CFR 1.3(ggg)(4)(ii). Commission staff published for public comment a preliminary report on the de minimis exception in November 2015, with comments due by January 19, 2016. *See* Swap Dealer De Minimis Exception Preliminary Report (Nov. 18, 2015), available at *http://www.cftc.gov/idc/groups/public/@swaps/documents/file/dfreport_sddeminis_1115.pdf.* The comment file is available at *http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1634.* Note that Commission regulation 1.3(ggg)(4) also contains separate de minimis exceptions related to transactions in which the counterparty is a ''special entity'' or ''utility special entity.'' *See* 17 CFR 1.3(ggg)(4)(i)(A)–(B). *See also* 17 CFR 1.3(ggg)(6) (identifying swaps that are not considered in determining whether a person is a swap dealer).

[74] *See* 17 CFR 1.3(ggg)(4)(i)(A). For purposes of the Proposed Rule, 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. *See* 77 FR at 30631 n.437. Accordingly, any reference in the Proposed Rule to ''affiliates under common control'' with a person would include affiliates that are controlling, controlled by, or under common control with such person.

[75] *See* proposed rule § 1.3(ggg)(7).

[76] The preamble of this release uses the term ''U.S. Guaranteed Entity'' for convenience only. Whether a non-U.S. person would be considered a U.S. Guaranteed Entity would vary on a swap-by-swap basis, such that a non-U.S. person may be considered a U.S. Guaranteed Entity for one swap and not another, depending on whether the non-U.S. person's obligations under the swap are guaranteed by a U.S. person.

[77] *See* section V, *infra,* for a discussion of the Commission's proposed cross-border approach to applying the MSP registration thresholds.

statutory authority, while mitigating market distortions and inefficiencies.

A. U.S. Persons and U.S. Guaranteed Entities

Under the Proposed Rule, a U.S. person would include all of its swap dealing transactions in its de minimis threshold calculation without exception. As discussed in section II.A above, the term ''U.S. person'' encompasses a person who, by virtue of being domiciled or organized in the United States (or in the case of the unlimited U.S. responsibility prong, because U.S. person owner(s) serve as a financial backstop for all of the legal entity's obligations and liabilities), raises the concerns intended to be addressed by the Dodd-Frank Act, regardless of the U.S. person status of its counterparty. Additionally, a person's status as a U.S. person would be determined at the entity level and thus a U.S. person would include the swap dealing activity of foreign branches or operations that are part of the same legal person. The Commission notes that the proposed rule's requirement that a U.S. person include all of its swap dealing transactions in its de minimis calculation is consistent with the Guidance.[78]

The proposed rule would also require a non-U.S. person that is not an FCS to include in its de minimis calculation swap dealing transactions with respect to which it is a U.S. Guaranteed Entity. The Commission believes that this result is appropriate because the swap of a non-U.S. person whose swap obligations are guaranteed by a U.S. person is identical, in relevant aspects, to a swap entered into directly by a U.S. person.[79] As a result of the guarantee, the U.S. guarantor bears risk arising out of the swap as if it had entered into the swap directly. The U.S. guarantor's financial resources in turn enable the non-U.S. affiliate to engage in dealing activity, because the affiliate's counterparties will look to both the U.S. 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 U.S. Guaranteed Entity and the U.S. guarantor effectively act together to engage in the dealing activity.

Furthermore, treating U.S. Guaranteed Entities differently from U.S. persons could create a substantial regulatory loophole, incentivizing U.S. persons to conduct their dealing business with non-U.S. counterparties through non-U.S. affiliates, with a U.S. guarantee, to avoid application of the Dodd-Frank swap dealer 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 swap provisions and related Commission regulations. Applying the same standard to similar transactions instead helps to limit those incentives and regulatory implications.

B. Foreign Consolidated Subsidiaries

Under the proposed rule, a Foreign Consolidated Subsidiary would include all of its swap dealing transactions in its de minimis threshold calculation, without exception.[80] The Commission believes that the swap dealing transactions of an FCS should be treated in the same manner as swap dealing transactions of a U.S. person (and U.S. Guaranteed Entity) for purposes of the de minimis threshold calculation, given the nature of the relationship between the FCS and its U.S. ultimate parent entity. As discussed in section II.B. above, an FCS is under the financial control of its U.S. ultimate parent entity. Further, by virtue of consolidated reporting under U.S. GAAP, the swap activity of an FCS creates a direct risk for the U.S. ultimate parent entity. The Commission is also concerned that offering FCSs disparate treatment compared to U.S. persons could incentivize U.S. entities to conduct swap activities with non-U.S. counterparties through consolidated non-U.S. subsidiaries in order to avoid application of the Dodd-Frank Act SD requirements, creating the potential for a substantial regulatory loophole.

C. Other Non-U.S. Persons

Under the proposed rule, whether an Other Non-U.S. Person would include a particular swap in its de minimis calculation would depend on the status of the counterparty. Specifically, as further explained below, an Other Non-U.S. Person would be required to include in its de minims threshold calculation its dealing activities with U.S. Persons, U.S. Guaranteed Entities, and FCSs, but not with Other Non-U.S. Persons (''Other Non-U.S. counterparties''). Additionally, Other Non-U.S. Persons would not be required to include in their de minimis threshold calculation any transaction that is executed anonymously on a swap execution facility (''SEF''), designated contract market (''DCM''), or foreign board of trade (''FBOT'') and cleared through a registered or exempt derivatives clearing organization (''DCO'').

1. U.S. Counterparties that are U.S. Persons or U.S. Guaranteed Entities

Under the proposed rule, an Other Non-U.S. Person would generally include in its de minimis calculation all swap dealing transactions with U.S. counterparties, subject to the exception for transactions executed anonymously on a SEF, DCM, or FBOT and cleared (discussed in section 4 below). As a general rule, the Commission believes that all potential SDs should include in their de minimis calculations any swap with a U.S. counterparty.[81] As discussed in section II.A. 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. In the event of a default or insolvency of an Other Non-U.S. SD with more than a de minimis level of swap dealing, the SD's U.S. counterparties could be adversely affected. A credit event, including funding and liquidity problems, downgrades, default or insolvency at an Other Non-U.S. Person SD could therefore have a direct adverse impact on its U.S. counterparties, which could in turn create the risk of disruptions to the U.S. financial system.

The Commission notes that the proposed rule's requirement that an Other Non-U.S. Person include in its de minimis calculation all swap dealing

[78] *See* Guidance, 78 FR at 45326.

[79] For purposes of this proposed rulemaking, ''guarantee'' has the same meaning as defined in Commission regulation 23.160(a)(2) (cross-border application of the Commission's margin requirements for uncleared swaps), except that application of the proposed definition of ''guarantee'' would not be limited to uncleared swaps. Under this definition, a ''guarantee'' would include arrangements, 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. This ''guarantee'' definition also encompasses 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. *See* Cross-Border Margin Rule, 81 FR 34818.

[80] To the extent that a non-U.S. person is both an FCS and a U.S. Guaranteed Entity with respect to a particular swap, the non-U.S. person would only be required to include the swap in its SD de minimis calculation once. *See* proposed rule § 1.3(ggg)(7).

[81] As discussed above, the definition of ''U.S. person'' includes any foreign branch. *See* proposed rule § 1.3(aaaaa)(5)(iii), (vi) (defining ''U.S. person'' to include ''any branch of the legal entity'').

transactions with U.S. person counterparties (subject to the exception for swaps executed anonymously on a SEF, DCM, or FBOT and cleared, discussed in section 4 below) is largely consistent with the Guidance, except with respect to the treatment of swaps with foreign branches of U.S. SDs. Under the Guidance, a non-U.S. person that is not a ''guaranteed affiliate'' or a ''conduit affiliate'' (as those terms are interpreted in the Guidance) [82] would generally include in its de minimis threshold calculations all swap transactions with counterparties that are U.S. persons, except transactions with foreign branches of U.S. SDs.[83] This exception was primarily driven by concerns that, absent such an exception, non-U.S. counterparties would avoid transacting with U.S. SDs.[84]

Upon further consideration, however, the Commission believes that incorporating a similar exception into the proposed rule could create a substantial regulatory loophole. As discussed above, a foreign branch is an integral part of a U.S. person, such that a transaction involving a foreign branch of a U.S. SD poses risk to the U.S. SD itself and, consequently, the U.S. financial system. Allowing Other Non-U.S. Persons to engage in potentially unlimited swap dealing with foreign branches of U.S. SDs without having to register as SDs could therefore result in a substantial amount of dealing activity with U.S. counterparties occurring outside the comprehensive Dodd-Frank swap regime, undermining the effectiveness of the proposed rule.

Under the proposed rule, an Other Non-U.S. Person would also include in its de minimis threshold calculation swap dealing transactions with a non-U.S. person that is a U.S. Guaranteed Entity, subject to an exception for transactions executed anonymously on a SEF, DCM, or FBOT and cleared.[85] The Commission notes that the guarantee of a swap is an integral part of the swap and that, as discussed above, counterparties may not be willing to enter into a swap with a U.S. Guaranteed Entity in the absence of the guarantee. The Commission also recognizes that, given the highly-integrated corporate structures of global financial groups 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 recourse guarantee from a U.S. person. Therefore, in order to avoid creating a substantial regulatory loophole, the Commission believes that swaps of an Other Non-U.S. Person with a U.S. Guaranteed Entity should receive the same treatment as swaps with a U.S. person and should therefore be included in the Other Non-U.S. Person's SD de minimis calculation. If Other Non-U.S. Persons were not required to include such transactions in their SD de minimis threshold calculations, they could engage in a significant level of swap dealing activity with U.S. Guaranteed Entities without being required to register as SDs. Treating swaps of Other Non-U.S. Persons with U.S. Guaranteed Entities differently than their swaps with U.S. persons could thereby undermine the effectiveness of the Dodd-Frank swap provisions and related Commission regulations.

2. Counterparties That Are FCSs

Under the proposed rule, an Other Non-U.S. Person would include in its de minimis threshold calculation swap dealing transactions with a non-U.S. person that is an FCS, subject to an exception for transactions executed anonymously on a SEF, DCM, or FBOT and cleared. As discussed above, the default or insolvency of an Other Non-U.S Person could have a direct adverse effect on an FCS, which through the interconnection to its U.S. ultimate parent, could have knock-on effects, potentially leading to disruptions to the U.S. financial system. The Commission believes that such risk would be significant to the extent that the Other Non-U.S. Person's dealing activities with FCSs, U.S. persons and U.S. Guaranteed Entities [86] exceed the de minimis threshold.

3. Other Non-U.S. Counterparties

Under the proposed rule, an Other Non-U.S. Person would not include in its de minimis calculation its swap dealing transactions with an Other Non-U.S. Person. This approach reflects the Commission's recognition of foreign jurisdictions' strong supervisory interest in the swap transactions between Other Non-U.S. Persons, both of which are domiciled and operate abroad. Consistent with comity principles, the Commission believes that it would be appropriate to except this class of swap transactions from counting against the de minimis threshold.

Further, the proposed rule would not require an Other Non-U.S. Person to include a swap transaction with an Other Non-U.S. Person counterparty in its de minimis threshold calculation even if the swap is arranged, negotiated, or executed by personnel located in the United States. Although, as stated above, a non-U.S. person that engages in ANE transactions is performing dealing activity in the United States, the Commission preliminarily does not believe that requiring Other Non-U.S. Persons to include ANE transactions in their de minimis threshold calculations would be necessary to advance the policy objectives of the Dodd-Frank swap regime when taking the proposed rule in context. In particular, the Commission preliminarily believes that the proposal to require FCSs to include all of their swap dealing transactions in their de minimis threshold calculations would capture a substantial portion of dealing activity engaged in by non-U.S. persons in which the Commission has a strong regulatory interest, such that the level of ANE transactions engaged in by Other Non-U.S. Persons may be comparatively insignificant. Additionally, Other Non-U.S. Persons that engage in ANE transactions could either be registered already by virtue of their swap transactions with U.S. persons or, if the proposed rule is adopted, be required to register as SDs by virtue of their swap transactions with U.S. persons, U.S. Guaranteed Entities or FCSs.

4. Swaps Executed Anonymously on a SEF, DCM, or FBOT and Cleared

The Commission believes that when an Other Non-U.S. Person enters into a swap that is executed anonymously on a registered SEF, DCM, or FBOT and the swap is cleared through a registered or exempt DCO, the Other Non-U.S. Person may exclude the swap from its de minimis threshold calculation.[87] The Commission recognizes that, under these circumstances, the Other Non-U.S. Person would not have the necessary information about its counterparty to determine whether the swap should be included in its de minimis threshold calculation. The Commission therefore believes that in this case the practical

[82] *See* Guidance, 78 FR at 45318, n.257–58. The Guidance uses the terms ''conduit affiliate'' and ''affiliate conduit'' interchangeably.

[83] *See id.* at 45318–19.

[84] *See id.* at 45324.

[85] To the extent that the swap is with a non-U.S. counterparty that is both an FCS and a U.S. Guaranteed Entity with respect to a particular swap, the Other Non-U.S. Person would only be required to include the swap in its SD de minimis calculation once. *See* proposed rule § 1.3(ggg)(7).

[86] *Id.*

[87] The Commission clarifies that an Other Non-U.S. Person would also be able exclude from its de minimis threshold calculation any swap that is executed anonymously on a foreign trading platform that is subject to relief from the requirement to register as a SEF or DCM, provided the swap is cleared through a registered or exempt DCO.

difficulties make it reasonable for the swap to be excluded altogether.[88]

D. Aggregation Requirement

As stated above, Commission regulation 1.3(ggg)(4) requires that, in determining whether its swap dealing transactions exceed the de minimis threshold, a person must include the aggregate notional value of any swap dealing transactions entered into by its affiliates under common control. Consistent with CEA section 2(i), the Commission interprets the aggregation requirement in Commission regulation 1.3(ggg)(4) in a manner that applies the same aggregation principles to all affiliates in a corporate group, whether they are U.S. or non-U.S. persons. Accordingly, under the proposed rule, a potential SD, whether a U.S. or non-U.S. person, would aggregate all swaps connected with its dealing activity with those of persons controlling, controlled by, or under common control with [89] the potential SD to the extent that these affiliated persons are themselves required to include those swaps in their own de minimis thresholds, unless the affiliated person is itself a registered SD. The Commission notes that this interpretation, which mirrors the approach taken in the Guidance,[90] ensures that the aggregate notional value of applicable swap dealing transactions of all such unregistered U.S. and non-U.S. affiliates does not exceed the de minimis level.

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

E. Summary

In summary, under the proposed rule, in making its de minimis calculation:

- A U.S. person would include all of its swap dealing transactions.
- A non-U.S. person would include all swap dealing transactions with respect to which it is a U.S. Guaranteed Entity.
- A Foreign Consolidated Subsidiary would include all of its swap dealing transactions.
- An Other Non-U.S. Person would include all of its swap dealing transactions with counterparties that are U.S. persons, U.S. Guaranteed Entities, or FCSs, unless the swap is executed anonymously on a registered SEF, DCM, or FBOT and cleared. It would not, however, include any of its swap dealing transactions with Other Non-U.S. Persons, even if they constitute ANE transactions.
- All potential SDs, whether U.S. or non-U.S. persons, would aggregate their swap dealing transactions with those of persons controlling, controlled by, or under common control with the potential SD to the extent that those affiliates are themselves required to include those swaps in their own de minimis thresholds, unless the affiliated person is a registered SD.

Request for Comment. The Commission invites comment on all aspects of Proposed Rule, including the following:

1. The Commission invites comment on the appropriateness, necessity, and potential impact of requiring Other Non-U.S. Persons to include ANE transactions in their de minimis threshold calculations. Should the Commission further harmonize with the SEC by requiring Other Non-U.S. Persons to include ANE transactions in their de minimis threshold calculations? [91] What effect would a determination not to impose such a requirement have on market liquidity and competitiveness? To what degree would U.S. swap dealers be adversely affected? Would a determination not to impose such a requirement create a substantial loophole or otherwise expose the U.S. financial system to unregulated risk? Do ANE transactions conducted by Other Non-U.S. Persons, particularly those not currently registered as SDs by virtue of their transactions with U.S. persons, form a significant segment of the U.S. swap market? The Commission is particularly interested in data or estimates regarding the current level of ANE transactions entered into by Other Non-U.S. Persons, including whether and how many Other Non-U.S. Persons that are not currently registered as SDs would exceed the current de minimis threshold as a result of being required to include ANE transactions in their de minimis threshold calculations.

2. The Commission invites comment on whether and to what extent the Proposed Rule should incorporate certain exceptions for non-U.S. persons that were included in the Guidance.[92] Specifically, should the proposed rule permit Other Non-U.S. Persons to exclude from their de minimis threshold calculations:

a. Swap transactions with foreign branches of U.S. SDs? If so, why and how should the Commission interpret the term ''foreign branch of a U.S. swap dealer'' (*e.g.,* consistent with the Guidance,[93] consistent with the SEC's definitions of ''foreign branch'' and ''transaction conducted through a foreign branch'' in Exchange Act rules,[94] or an alternative approach)?

[88] The Commission also believes that when an Other Non-U.S. Person clears a swap through a registered or exempt DCO, such Other Non-U.S. Person would not have to include the resulting swap (*i.e.,* the novated swap) in its de minimis threshold calculation. A swap that is submitted for clearing is extinguished upon novation and replaced by new swap(s) that result from novation. *See* Commission regulation 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.

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

[90] *See* 78 FR at 45323.

[91] *See* SEC ANE Rule, 81 FR at 8621.

[92] *See* 78 FR at 45324 (providing that non-U.S. persons that are not guaranteed or conduit affiliates would generally not count toward their de minimis threshold calculations their swap dealing transactions with (i) a foreign branch of a U.S. swap dealer, (ii) a guaranteed affiliate of a U.S. person that is a swap dealer, and (iii) 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).

[93] *See id.* at 45328–31 (discussing the scope of the term ''foreign branch'' and Commission's consideration of whether a swap is with a foreign branch of a U.S. bank).

[94] The SEC defined the term ''foreign branch'' in Exchange Act rule 3a71–3(a)(2), 17 CFR 240.3a71–3(a)(2), to mean any branch of a U.S. bank if (i) the branch is located outside the United States; (ii) the branch operates for valid business reasons; and (iii) the branch is engaged in the business of banking and is subject to substantive banking regulation in the jurisdiction where located. The SEC defined the term ''transaction conducted through a foreign branch'' in Exchange Act rule 3a71–3(a)(3), 17 CFR 240.3a71–3(a)(3), to mean a security-based swap transaction that is arranged, negotiated, and executed by a U.S. person through a foreign branch of such U.S. person if (A) the foreign branch is the counterparty to such security-based swap transaction; and (B) the security-based swap transaction is arranged, negotiated, and executed on behalf of the foreign branch solely by persons

Continued

b. Any swap transactions with U.S. Guaranteed Entities? If so, why and under what circumstances?

3. The Commission is concerned that a non-U.S. person that is affiliated with a U.S. SD could act as a conduit or an extension of the affiliated U.S. SD by entering into market-facing swaps in a foreign jurisdiction and then transferring some or all of the risk of such swaps to its affiliated U.S. SD through one or more inter-affiliate swaps. Furthermore, under the Proposed Rule, an Other Non-U.S. Person would not be required to include its market-facing swaps with Other Non-U.S. counterparties in its SD de minimis threshold. The Commission invites comment as to whether Other Non-U.S. Persons should be required to include market-facing swaps with non-U.S. persons in their de minimis threshold calculations if any of the risk of such swaps is transferred to an affiliated U.S. SD through one or more inter-affiliate swaps and as to whether it would be too complex or costly to monitor and implement.[95] If so:

a. Should an Other Non-U.S. Person that is consolidated with an affiliated U.S. SD for financial reporting purposes and that transfers some or all of the risk of a swap with an Other Non-U.S. counterparty, directly or indirectly, to its affiliated U.S. SD (an ''SD conduit'') be required to count outward-facing swap as to which it acts as a conduit toward its SD or MSP registration threshold?

b. Should an Other Non-U.S. Person be considered an SD Conduit only when it ''regularly'' acts as an SD Conduit, and if so, how would the Commission determine whether it ''regularly'' acts as an SD Conduit?

c. Would it be appropriate to require an SD Conduit to include a market-facing swap in its de minimis threshold calculation in its entirety, for ease of calculation, even if not all of the risk arising out of that swap is transferred to an affiliated U.S. SD through inter-affiliate swaps? Is the Commission's assumption that a formula to calculate the percentage of risk would be too costly and burdensome to implement correct? If not, please propose such a workable formula. Alternatively, should an SD Conduit be required to include all of its swap dealing transactions (and not just those as to which it acts as an SD conduit) in its SD or MSP registration threshold?

d. The Commission understands that a non-U.S. person may aggregate all or a group of its market-facing swaps and then transfer all or a portion of the risk of such swaps as one position to the affiliated U.S. SD. In that case, the Commission understands that it would not be burdensome for the non-U.S. person to disaggregate the netted swap, as the non-U.S. person's trading system would aggregate these trades initially, and therefore should be able to perform a disaggregation function. Is the Commission's understanding correct?

e. Should the proposed rule be modified to require that Other Non-U.S. Persons include swaps in their SD or MSP registration thresholds if their counterparty is acting as an SD Conduit?

f. Should swaps where either one of the counterparties is acting as an SD conduit be subject to other Dodd-Frank requirements (in addition to SD and MSP registration thresholds) in future rulemakings?

V. Cross-Border Application of the Major Swap Participant Registration Thresholds

CEA section 1a(33) defines ''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.[96] 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.[97] 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.[98] The Commission also adopted interpretive guidance 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'').[99]

The Commission is now proposing rules to address the cross-border application of the MSP thresholds to the swap positions of U.S. and non-U.S. persons.[100] Applying CEA section 2(i) and principles of international comity, the proposed rule identifies when a potential MSP's cross-border swap positions should apply toward the MSP thresholds and when they may be properly excluded. As discussed in the sections below, whether a potential registrant would include a particular swap in its MSP calculations would depend on whether the potential registrant is a U.S. person, a U.S. Guaranteed Entity,[101] or a Foreign Consolidated Subsidiary (section A) or an Other Non-U.S. Person [102] (section B). Section C addresses the cross-border application of the attribution requirement. Section D provides an overall summary of the rule. If adopted, the Proposed Rule would supersede the Commission's Cross-Border Guidance with respect to the cross-border application of the MSP thresholds.

A. U.S. Persons, U.S. Guaranteed Entities, and Foreign Consolidated Subsidiaries

Under the proposed rule, all of a U.S. person's swap positions would apply

located outside the United States. *See also* SEC Cross-Border Rule, 79 FR 47278.

[95] The Commission notes that the Commission's final margin rule requires CSEs to collect initial margin from certain affiliates that are not subject to comparable initial margin collection requirements on their own outward-facing swaps with financial end-users, which addresses some of the credit risks associated with the outward-facing swaps. *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636, 703 (Jan. 6, 2016) (''Final Margin Rule'').

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

[97] *See* 17 CFR 1.3(hhh)–(mmm). *See also* Dodd Frank Act section 712(d)(1) (directing the Commission and the SEC, in consultation with the Board of Governors of the Federal Reserve System, to jointly further define, among other things, the term ''major swap participant''); 7 U.S.C. 1a(33)(B) (directing the Commission to further define ''substantial position'' at the threshold the Commission deems prudent for the effective monitoring, management, and oversight of entities that are systemically important or can significantly impact the U.S. financial system); Entities Rule, 77 FR 30596.

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

[99] *Id.* at 30689.

[100] *See* proposed rule § 1.3(nnn).

[101] *See* notes 76 and 79, *supra.*

[102] As indicated above, for purposes of the Proposed Rule, an ''Other Non-U.S. Person'' refers to a non-U.S. person that is neither an FCS nor a U.S. Guaranteed Entity. *See* section IV, *supra.*

toward the MSP thresholds without exception. As discussed in the context of the Proposed 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 their swap activities. 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, present risk to the stability of the U.S. financial system and U.S. entities, including those that may be systemically important, and thus should apply toward the MSP thresholds.

For related reasons, the proposed rule would also require a non-U.S. person that is not an FCS to include in its MSP calculations each swap position with respect to which it is a U.S. Guaranteed Entity. As explained in context of the SD de minimis threshold calculation, the Commission believes that the swap positions of a non-U.S. person whose swap obligations are guaranteed by a U.S. person are identical, in relevant aspects, to those entered into directly by a U.S. person and thus present risks to the stability of the U.S. financial system or of U.S. entities. Treating U.S. Guaranteed Entities differently from U.S. persons could also create a substantial regulatory loophole, allowing transactions that have a similar connection to or impact on U.S. commerce to be treated differently depending on how the parties are structured and thereby undermining the effectiveness of the Dodd-Frank swap provisions and related Commission regulations.

The proposed rule would also require an FCS to include all of its swap positions in its MSP calculations.[103] As discussed in the context of applying the SD de minimis threshold, by virtue of its relationship to its U.S. ultimate parent, the risk associated with an FCS's swap positions have a direct impact on the financial position and risk profile of its U.S. parent. Accordingly, should the FCS or its counterparty default on a swap, the financial stability of the U.S. ultimate parent entity would be directly impacted, raising the types of regulatory concerns that MSP registration is intended to address. The Commission is also concerned that offering disparate treatment to FCSs compared to U.S. persons could create a substantial regulatory loophole, incentivizing U.S. financial groups to conduct their swap activities with non-U.S. counterparties through non-U.S. subsidiaries and thereby undermining the effectiveness of the Dodd-Frank swap provisions and related Commission regulations.

B. Other Non-U.S. Persons

Under the proposed rule, an Other Non-U.S. Person would include all of its swaps with U.S. persons, U.S. Guaranteed Entities, and Foreign Consolidated Subsidiaries in its MSP calculations, with a limited exception for transactions executed anonymously on a SEF, DCM, or FBOT and cleared.[104] As discussed above, the default or insolvency of the Other Non-U.S. Person would have a direct adverse effect on a U.S. counterparty and, by virtue of the U.S. person's significant nexus to the U.S. financial system, potentially could result in adverse effects or disruption to the U.S. financial system as a whole, particularly if the Other Non-U.S. Person's swap positions are substantial enough to exceed an MSP registration threshold.

The default or insolvency of the Other Non-U.S. Person would also present a financial impact to the U.S. financial system where the counterparty is an FCS because its U.S. ultimate parent would be directly impacted. The Other Non-U.S. Person's default could also impact the United States through a U.S. Guaranteed Entity. Although the default on that swap may not directly affect the U.S. guarantor on that swap, the default could affect the U.S. Guaranteed Entity's ability to meet its other obligations, for which the U.S. guarantor may also be liable. The Commission is also concerned that offering Other Non-U.S. Persons disparate treatment with respect to their swap positions with U.S. Guaranteed Entities compared to their swap positions with FCSs could incentivize Other Non-U.S. Persons to favor transacting with U.S. Guaranteed Entities solely in order to avoid application of the Dodd-Frank swap provisions.

The Commission therefore has a strong regulatory interest in ensuring that Other Non-U.S. Persons are subject to the Dodd-Frank MSP requirements to the extent that their swap positions with U.S. Guaranteed Entities and FCSs exceed a registration threshold. Accordingly, the Commission believes that requiring Other Non-U.S. Persons to include their swap positions with FCSs and U.S. Guaranteed Entities as well as U.S. persons appropriately captures swap positions that present a risk to the U.S. financial system, ensuring that MSP regulation applies once that risk exceeds the relevant thresholds. However, as discussed in the context of the SD de minimis threshold, where the swap is executed anonymously on a SEF, DCM, or FBOT and cleared, the Commission believes that the practical difficulties involved in determining the status of the potential MSP's counterparty would make it reasonable for the swap position to be excluded altogether.[105]

Where the counterparty is an Other Non-U.S. Person, however, the proposed rule would not require an Other Non-U.S. Person to include the swap position in its MSP calculations, as the Commission does not believe the swap would present the type of risk to the U.S. financial system that MSP registration is intended to address.[106] Further, the Commission clarifies that under the Proposed Rule, an Other Non-

[103] To the extent that a non-U.S. person is both an FCS and a U.S. Guaranteed Entity with respect to a particular swap, the non-U.S. person would only be required to include the swap position in its MSP calculations once. *See* proposed rule § 1.3(nnn).

[104] To the extent that the Other Non-U.S. Person's swap position is with a non-U.S. counterparty that is both an FCS and a U.S. Guaranteed Entity with respect to a particular swap, the Other Non-U.S. Person would only be required to include the swap position in its MSP calculations once. *See* proposed rule § 1.3(nnn).

[105] *See* section IV.C.4, *supra.*

[106] The Commission notes that the Guidance provided that non-U.S. persons that are not guaranteed affiliates generally could exclude from their MSP threshold calculations swap positions with either a foreign branch of a U.S. SD or a guaranteed affiliate that is an SD if either (i) the potential non-U.S. MSP is a non-financial entity or (ii) the potential non-U.S. MSP is a financial entity *and* the swap is either cleared or the swap documentation requires the foreign branch or guaranteed affiliate to collect daily variation margin with no threshold. *See* Guidance, 78 FR at 45324–25. The Commission has determined that a similar exception in the Proposed Rule with regard to the swap positions of Other Non-U.S. Persons would be unnecessary and inappropriate because (1) two of the three prongs of the statutory MSP definition apply regardless of whether the potential MSP is a financial entity, *see* 7 U.S.C. 1a(33)(A)(i)–(ii), and (2) although subjecting a swap to the clearing or margin requirements may mitigate some of the risk of the swap, the risk is not entirely eliminated, and the mitigation effect of the clearing and margin requirements is taken into account in calculating the relevant MSP thresholds. *See* 17 CFR 1.3(jjj)(3)(iii) (defining ''substantial position'' such that the potential future exposure associated with positions that are subject to central clearing by a registered or exempt DCO is equal to 0.1 times the potential future exposure that would otherwise be calculated). Accordingly, the Commission believes that such swaps create the potential for systemic risk within the meaning of the MSP definition and that allowing such exclusion would allow market participants to inappropriately avoid the Dodd-Frank registration and other associated requirements that are designed to mitigate that risk. The Commission further believes that the Proposed Rule has the added benefit of aligning more closely with the SEC in this regard, which should serve to reduce compliance costs associated with MSP registration.

U.S. Person would not be required to include its swap position with an Other Non-U.S. Person counterparty in its MSP calculations solely by reason of such swap being arranged, negotiated, or executed by personnel located in the United States. As stated above, arranging, negotiating, or executing swaps are functions that fall within the scope of the ''swap dealer'' definition. In contrast, the definition of MSP focuses primarily on credit risk and thus, the Commission does not believe that including ANE transactions in this context would address the regulatory concerns underlying the MSP registration requirement.

C. Attribution Requirement

In the Entities Rule, the Commission and the SEC (collectively, ''Commissions'') provided a joint interpretation that an entity's swap positions in general would be attributed to a parent, other affiliate, or guarantor for purposes of the MSP analysis to the extent that the counterparties to those positions have recourse to the parent, other affiliate, or guarantor in connection with the position, such that no attribution would be required in the absence of recourse.[107] Even in the presence of recourse, however, the Commissions stated that attribution of a person's swap positions to a parent, other affiliate, or guarantor would not be necessary if the person is already subject to capital regulation by the Commission or the SEC or is a U.S. entity regulated as a bank in the United States (and is therefore subject to capital regulation by a prudential regulator).[108]

The Commission is also proposing to address the cross-border application of the attribution requirement in a manner consistent with the Entities Rule and CEA section 2(i) and generally comparable to the approach adopted by the SEC.[109] Specifically, the Commission believes that the swap positions of an entity, whether a U.S. or non-U.S. person, should not be attributed to a parent, other affiliate, or guarantor for purposes of the MSP analysis in the absence of recourse. Even in the presence of recourse, 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.[110]

If recourse is present, however, and the entity subject to a recourse guarantee (''guaranteed entity'') is not subject to capital regulation (as described above), whether the attribution requirement would apply would depend on the U.S. person status of the person to whom there is recourse (*i.e.,* the U.S. person status of the guarantor). Specifically, a U.S. person guarantor would attribute to itself any swap position of a guaranteed entity, whether a U.S. person or a non-U.S. person, for which the counterparty to the swap has recourse against that U.S. person guarantor. The Commission believes that when a U.S. person acts as a guarantor of a swap position, the recourse 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 guaranteed entity or its counterparty.[111]

A non-U.S. person would attribute to itself any swap position of an entity for which the counterparty to the swap has recourse against the non-U.S. person *unless* all relevant persons (*i.e.,* the non-U.S. person guarantor, the entity subject to the recourse guarantee, and its counterparty) are Other Non-U.S. Persons. In this regard, the Commission believes that when a non-U.S. person provides recourse 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. Additionally, the Commission believes that guaranteed entities would be able to enter into significantly more swap positions (and take on significantly more risk) as a result of the guarantee than they would otherwise, amplifying the risk of the non-U.S. person guarantor's inability to carry out its obligations under the guarantee. Given that, as discussed above, the Commission believes that the swap positions of U.S. persons, FCSs, and U.S. Guaranteed Entities present 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 recourse guarantees to U.S. persons, FCSs, and U.S. Guaranteed Entities. Accordingly, the Commission believes that a non-U.S. person should be required to attribute to itself the swap positions of any entity for which it provides a recourse guarantee unless it, the guaranteed entity, and its counterparty are Other-Non-U.S. Persons.

D. Summary

In summary, under the proposed rule, in making its MSP threshold calculations:

- A U.S. person would include all of its swap positions.
- A non-U.S. person would include all swap positions with respect to which it is a U.S. Guaranteed Entity.
- A Foreign Consolidated Subsidiary would include all of its swap positions.
- An Other Non-U.S. Person would include all of its swap positions with counterparties that are U.S. persons, U.S. Guaranteed Entities, or FCSs, unless the swap is executed anonymously on a registered SEF, DCM, or FBOT and cleared. It would not, however, include any of its swap positions with Other Non-U.S. counterparties.
- All swap positions that are subject to recourse should also be attributed to a 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.

Request for Comment. The Commission invites comment on all aspects of the proposed rule, including the following:

1. The Commission invites comment on whether it should provide an exception for Other Non-U.S. Persons similar to that included in the Guidance for non-U.S. persons that are not guaranteed affiliates trading with either a foreign branch of a U.S. SD or a guaranteed affiliate that is an SD.[112] Would such an exception be appropriate or otherwise consistent with the proposed rule? Why or why not?

2. In its rulemaking addressing the cross-border application of the MSP thresholds, the SEC determined not to require a non-U.S. person to include in its major security-based swap participant threshold calculations any security-based swap positions for which they (as opposed to their counterparty)

[107] *See* 77 FR at 30689.

[108] *Id.* (positions of U.S. entities regulated as banks in the United States would be subject to capital and other requirements, making it unnecessary to separately address the risks associated with guarantees of those positions via MSP regulation). *See also id.* at n.1134 (''As a result of this interpretation, holding companies will not be deemed to be major participants as a result of guarantees to certain U.S. entities that already are subject to capital regulation. The Commissions intend to address guarantees provided to non-U.S. entities, and guarantees by non-U.S. holding companies, in separate releases.'').

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

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

[111] *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).

[112] *See* note 106, *supra.*

benefit from a guarantee creating a right of recourse against a U.S. person.[113] The SEC argued that if the non-U.S. person were to default, it would not pose a direct risk to its counterparty's U.S. guarantor, as the non-U.S. person's failure under the swap would not trigger any obligations under the guarantee of the swap. The Commission invites comment on whether it should adopt a similar approach and whether such an approach would be consistent with the Proposed Rule.

3. Should the Commission modify its interpretation with regard to the attribution requirement to further harmonize with the approach presented in the Guidance [114] and adopted by the SEC [115] and 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 a home country supervisor or regulator? If so, should the home country capital standards be deemed comparable and comprehensive if they are consistent in all respects with the Capital Accord of the Basel Committee on Banking Supervision (''Basel Accord'')?

VI. Cross-Border Application of the External Business Conduct Standards for Swap Dealers and Major Swap Participants

Pursuant to CEA section 4s(h), the Commission has adopted rules establishing business conduct standards governing the conduct of SD/MSPs in transacting with swap counterparties.[116] Broadly speaking, the external business conduct standards are designed to enhance counterparty protections by expanding the obligations of SD/MSPs with respect to their counterparties.[117] Among other things, SDs and/or MSPs are required to conduct due diligence on their counterparties to verify their eligibility to trade; 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.[118]

The Commission is now proposing a rule to address the cross-border application of the external business conduct standards, including the extent to which they would apply to ANE transactions.[119] Specifically, under the proposed rule, U.S. SD/MSPs, other than with respect to transactions conducted through foreign branches of U.S. SD/MSPs, would be required to comply with the Commission's applicable external business conduct standards regardless of the status of the counterparty as a U.S. person (or as a foreign branch of a U.S. SD/MSP) [120] without substituted compliance. This requirement reflects the Commission's view that the Dodd-Frank's external business conduct standards should apply fully to registered SD/MSPs domiciled and operating in the United States because their swap activities are particularly likely to affect the integrity of the swaps market in the United States and give rise to concerns about the protection of participants in those markets.[121]

Foreign branches of U.S. SD/MSPs as well as non-U.S. SD/MSPs (including FCSs and U.S. Guaranteed Entities) would be required to comply with all of the Commission's applicable external business conduct standards, without substituted compliance, to the extent that the counterparty is a U.S. person (other than a foreign branch of a U.S. SD/MSP).[122] Given the focus of the Dodd-Frank counterparty protection mandate on U.S. persons, the Commission believes that the external business conduct standards should apply fully to all swap transactions with U.S. persons that are not foreign branches of a U.S. SD/MSP.

With respect to transactions with counterparties that are foreign branches of U.S. SD/MSPs or non-U.S. persons (including FCSs and U.S. Guaranteed Entities), however, non-U.S. SD/MSPs and foreign branches of U.S. SD/MSPs would generally *not* be required to comply with the external business conduct rules, subject to one narrow exception: foreign branches of U.S. SDs and non-U.S. SDs that use personnel located in the United States to arrange, negotiate, or execute such transactions would be required to comply with Commission regulations 23.410 (Prohibition on Fraud, Manipulation, and other Abusive Practices) and 23.433 (Fair Dealing), without substituted compliance.[123] This position reflects the Commission's belief that, in general, imposing its customer protection standards on transactions between a foreign branch of a U.S. SD/MSP or a non-U.S. SD/MSP, on the one hand, and a counterparty that is a non-U.S. person or the foreign branch of a U.S. SD/MSP on the other, would generally not be necessary to advance the goals of the Dodd-Frank customer protection regime. However, to the extent that such SDs use personnel located in the United States to arrange, negotiate, or execute the swap transaction, the Commission believes that its interest in ensuring the

[113] *See* SEC Cross-Border Rule, 79 FR at 47345 & n.593.

[114] *See* 78 FR at 45326.

[115] *See* SEC Cross-Border Rule, 79 FR at 47347–48.

[116] *See* Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 77 FR 9734 (Feb. 17, 2012); 17 CFR 23.400–51.

[117] The term ''counterparty'' is defined for purposes of the external business conduct standards in 17 CFR 23.401 to include any person who is a prospective counterparty to a swap, as appropriate to subpart H.

[118] Note that certain external business conduct standards apply only to SDs and not MSPs. *See, e.g.,* 17 CFR 23.434 (recommendations to counterparties—institutional suitability); § 23.440 (requirements for swap dealers acting as advisors to Special Entities).

[119] The rule text for the cross-border application of external business conduct standards is proposed as § 23.452.

[120] As used in this preamble, the term ''U.S. SD/MSP'' refers to a U.S. person that is an SD or MSP and the term ''Non-U.S. SD/MSP'' refers to a non-U.S. person that is an SD or MSP.

[121] The Commission observes that, where a swap between a non-U.S. SD/MSP (or foreign branch of a U.S. SD/MSP) and a U.S. person is executed anonymously on a registered DCM or SEF and cleared by a registered or exempt DCO, the external business conduct standards are not applicable. *See, e.g.,* 17 CFR 23.402(b)–(c) (requiring swap dealers and MSPs to obtain and retain certain information only about each counterparty whose identity is known to the swap dealer or MSP prior to the execution of the transaction); § 23.430(e) (not requiring SD/MSPs to verify counterparty eligibility when a transaction is entered on a DCM or SEF and the swap dealer or MSP does not know the identity of the counterparty prior to execution); § 23.431(c) (not requiring disclosure of material information about a swap if initiated on a DCM or SEF and the swap dealer or MSP does not know the identity of the counterparty prior to execution). Because a registered FBOT is analogous to a DCM, the Commission is of the view that the requirements likewise would not be applicable where such a swap is executed anonymously on a registered FBOT and cleared.

[122] Although the Commission recognizes that foreign branches of U.S. SD/MSPs are part of the same legal entity as their U.S. principal, and that, from the standpoint of risk, there is no difference between a swap with a U.S. SD/MSP and a swap with its foreign branch, the Commission believes that for purposes of the external business conduct standards, which are oriented toward customer protection, a foreign branch of a U.S. SD/MSP should be treated the same as a non-U.S. SD/MSP. The Commission proposes to interpret the term ''foreign branch of a U.S. person'' that is a swap dealer (or MSP) as used in proposed rule § 23.452 in a manner that is consistent with the Guidance. *See* Guidance, 78 FR at 45328–31 (discussing the scope of the term ''foreign branch'' and the Commission's consideration of whether a swap is with a foreign branch of a U.S. bank).

[123] *See* section III for a discussion of the terms arrange, negotiate, and execute. The Commission notes that the external business conduct standards apply in connection with transactions in swaps as well as in connection with swaps that are offered but not entered into. *See* 17 CFR 23.400. Accordingly, Commission regulations 23.410 and 23.433 would apply where a non-U.S. SD uses personnel located in the United States to offer a swap even if that swap is not ultimately entered into.

integrity of U.S. markets is implicated. By limiting application of the external business conduct standards to ANE transactions to the antifraud and fair dealing requirements, the proposed rule is tailored to ensure a basic level of counterparty protections while, consistent with the principles of international comity, recognizing the supervisory interests of the relevant foreign jurisdictions in applying their own sales practices requirements to transactions involving counterparties that are non-U.S. persons or foreign branches of a U.S. SD/MSP. This approach recognizes the supervisory interests of the local jurisdiction with respect to swaps conducted within that jurisdiction and that broadly imposing U.S. external business conduct standards with respect to such transactions would not be necessary to advance the goals of the Dodd-Frank customer protection regime.

If adopted, the proposed rule would supersede the Guidance with respect to the cross-border application of the external business conduct standards.

Request for Comment. The Commission invites comment on all aspects of the proposed rule, including the following:

1. The Commission invites comment regarding its determination to distinguish transactions entered into by foreign branches of U.S. persons that are SDs (or MSPs) for purposes of the cross-border application of the external business conduct standards.[124] Should transactions involving foreign branches of U.S. SD/MSPs be treated in the same manner as transactions involving U.S. persons with respect to these requirements? Why or why not? Should the Commission, as proposed, interpret the term ''foreign branch of a U.S. person'' that is an SD (or MSP) in a manner consistent with the Guidance or incorporate an alternative approach, such as the definition of ''foreign branch'' in the SEC's Exchange Act rules? [125]

2. The Commission invites comment regarding the circumstances under which a swap transaction should be considered as being ''with a foreign branch of a U.S. person'' that is an SD (or MSP) as opposed to being with the U.S. person itself. Specifically, should the Commission, as proposed, adopt an interpretation consistent with the Guidance [126] or should it incorporate an alternative approach, such the how the SEC defines ''transaction conducted through a foreign branch'' in the context of its Exchange Act rules? [127]

3. The Commission invites comment on the proposed treatment of non-U.S. SD/MSPs and foreign branches of U.S. SD/MSPs. Whether and to what extent should their swap transactions with foreign branches of U.S. SD/MSPs and non-U.S. persons be subject to the external business conduct standards? Should they be required to comply with the external business conduct standards with respect to their transactions with foreign branches of U.S. SD/MSPs or non-U.S. persons? If so, should substituted compliance be available? Relatedly, should transactions conducted through foreign branches of U.S. SD/MSPs receive the same treatment as other transactions conducted by U.S. SD/MSPs? Is limiting the scope of applicable requirements for ANE transactions entered into by foreign branches of U.S. SDs or non-U.S. SDs to the antifraud and fair dealing requirements appropriate, or should other external business conduct requirements in subpart H of part 23 of the Commission's regulations also apply? Why or why not?

VII. 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.[128] 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.[129] The proposed regulation addresses when U.S. persons and non-U.S. persons would be required to include their cross-border swap dealing transactions or swap positions in their SD or MSP registration threshold calculations, respectively, as specified in the Proposed Rule,[130] and the extent to which SDs or MSPs would be required to comply with the Commission's external business conduct standards in connection with their cross-border swap transactions or swap positions.[131]

The Commission previously determined that SDs and MSPs are not small entities for purposes of the RFA.[132] 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.[133]

Under the proposed rule, to the extent that there are any affected small entities under the proposed rule, they will need to assess how they are classified under the proposed rule (*i.e.,* U.S. person, FCS, U.S. Guaranteed Entity, and Other Non-U.S. Person) and monitor their swap activities in order to determine whether they are required to register as an SD under the proposed rule. The Commission believes that market participants would only incur incremental costs, which are expected to be marginal, in modifying their existing systems and policies and procedures resulting from changes to the status quo made by the proposed rule.[134]

Accordingly, for the foregoing reasons, the Commission finds that

[124] *See* note 122, *supra.*

[125] *See* note 94, *supra.*

[126] *See* note 122, *supra.*

[127] *See* note 94, *supra.*

[128] *See* 5 U.S.C. 601 *et seq.*

[129] *See* 47 FR 18618 (Apr. 30, 1982) (finding that designated contract markets, future commission merchants, commodity pool operators and large traders are not small entities for RFA purposes).

[130] *See* proposed rule § 1.3(aaaaa), (ggg)(7), and (nnn).

[131] *See* proposed rule § 23.452.

[132] *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 future commission merchants, swap dealers will be subject to minimum capital requirements, and are expected to be comprised of large firms, and that major swap participants 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).

[132] *See* 77 FR at 30701.

[133] 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 affected by the Proposed Rule are generally large financial institutions or other large entities that would be required to include their cross border dealing transactions or swap positions towards the SD and MSP registration thresholds, respectively, as specified in the Proposed Rule.

[134] The proposed regulation addresses the cross-border application of the registration and external business conduct regulations. The Proposed Rule does not change the current registration requirements or external business conduct requirements.

there will not be a substantial number of small entities impacted by the proposed rule. Therefore, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the proposed regulations will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 [135] (''PRA'') imposes certain requirements on Federal agencies, including the Commission, in connection with conducting or sponsoring any ''collection of information,'' as defined by the PRA. Among its purposes, the PRA is intended to minimize the paperwork burden to the private sector, to ensure that any collection of information by a government agency is put to the greatest possible uses, and to minimize duplicative information collections across the government. The PRA applies to all information, ''regardless of form or format,'' whenever the government is ''obtaining, causing to be obtained, [or] soliciting'' information, and includes required ''disclosure to third parties or the public, of facts or opinions,'' when the information collection calls for ''answers to identical questions posed to, or identical reporting or recordkeeping requirements imposed on, ten or more persons.'' [136] The PRA requirements have been determined to include not only mandatory but also voluntary information collections, and include both written and oral communications.[137]

The proposed rule would result in an amendment to existing collections of information, ''Registration of Swap Dealers and Major Swap Participants,'' Office of Management and Budget (''OMB'') Control No. 3038–0072, as discussed below. The Commission, therefore, is submitting this proposed rulemaking to OMB for its review and approval in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. If the proposed rule is adopted, the responses to these collections of information would be mandatory. 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 issued by OMB.

The proposed rule provides for the cross-border application of the SD/MSP registration thresholds and external business conduct standards. The Commission estimates that if the proposed rule is adopted, 14 unregistered non-U.S. persons may be classified as FCSs and required to register as new SDs because their swap dealing transactions would be in excess of the SD de minimis threshold.[138] The Commission would increase the number of respondents under collection 3038–0072 accordingly. The proposed rule would not otherwise trigger any new recordkeeping, disclosure, or reporting requirements or cause any incremental burden under the PRA.

Information Collection Comments. The Commission invites the public and other Federal agencies to comment on any aspect of the reporting burdens discussed above. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (2) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information; (3) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (4) minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

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

C. Cost-Benefit Considerations

As detailed above, the Commission is proposing rules that would define certain key terms for purposes of the Dodd-Frank swap provisions and address the cross-border application of the SD and MSP registration thresholds and the Commission's external business conduct standards, including the extent to which such requirements would apply to ANE transactions.

The baseline against which the costs and benefits of this proposed rule are compared is the status quo, *i.e.,* the swap market as it exists today, with SD/MSP registration thresholds and external business conduct rules applied to cross-border transactions in a manner consistent with the Guidance and the Cross-Border Margin Rule.[139] In considering the costs and benefits of the proposed rule against this baseline, the Commission notes that the Commission's existing swap requirements, including the registration thresholds and external business conduct standards, were adopted pursuant to the requirements of the Dodd-Frank Act and have cross-border application by virtue of CEA section 2(i). A significant portion of the costs and benefits associated with the proposed rule are therefore inherent in the statute itself and were addressed in the cost-benefit considerations of the underlying registration rules and external business conduct standards at the time they were adopted. This cost-benefit discussion accordingly focuses on the central purpose and effect of the proposed rule, determining whether and to what extent the underlying SD/MSP registration thresholds and external business conduct standards should apply in a cross-border context, consistent with CEA section 2(i), the regulatory objectives of the Dodd-Frank Act, and principles of international comity.

The costs associated with the key elements of the Commission's proposed cross-border approach to the SD and MSP registration thresholds—requiring market participants to classify themselves as U.S. persons, U.S. Guaranteed Entities, Foreign Consolidated Subsidiaries, or Other Non-U.S. Persons and to apply the rule accordingly—fall into a few categories. Market participants would incur costs determining which category of market participant (*e.g.,* an FCS or an Other Non-U.S. Person) they 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

[135] 44 U.S.C. 3501 *et seq.*

[136] *See* 44 U.S.C. 3502.

[137] *See* 5 CFR 1320.3.

[138] *See* the Appendix to Cost-Benefit Considerations, *infra,* for an explanation of the Commission's estimate.

[139] Although the Guidance is non-binding, the Commission understands that market participants have developed policies and practices consistent with the views expressed therein.

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 as a result of the proposed rule would also incur costs associated with complying with the relevant Dodd-Frank requirements applicable to registrants, such as the capital, margin, and business conduct requirements (''programmatic costs'').[140] While only new registrants would be assuming these programmatic costs for the first time, the obligations of entities that are already registered as SDs may also change in the future as an indirect consequence of the proposed rule. Although the Proposed Rule does not address the cross-border application of any Dodd-Frank requirements other than the registration thresholds and external business conduct standards, the Commission expects that the proposed rule's classification scheme for market participants (as U.S. Persons, FCSs, etc.) and associated definitions (which closely track the approach adopted in the Cross-Border Margin Rule) would apply for purposes of future cross-border rulemakings. Accordingly, existing SDs may find that their cross-border compliance obligations with respect to other substantive Dodd-Frank requirements change in the future compared to the status quo as a result of having to adjust their classification (*e.g.,* from non-U.S. person to FCS). As a result, the full extent of the programmatic costs associated with the proposed rule would be influenced by the scope and effect of future rulemakings addressing the cross-border application of substantive requirements under the Dodd-Frank Act.

In developing the proposed rule, the Commission took into account the potential for creating or accentuating competitive disparities between market participants, which could contribute to market inefficiencies, including market fragmentation or decreased liquidity, as more fully discussed below. Significantly, 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/MSP registration thresholds apply to the various classifications of market participants. For instance, dealing subsidiaries with a U.S. ultimate parent entity (*i.e.,* FCSs)—which would be required to include all of their swap dealing transactions in their de minimis threshold calculations and therefore be more likely to trigger the SD registration threshold relative to Other Non-U.S. Persons—may be at a competitive disadvantage compared to Other Non-U.S. Persons when trading with non-U.S. counterparties, as non-U.S. counterparties may prefer to trade with non-registrants in order to avoid application of the Dodd-Frank swaps regime.[141] Again, the full competitive impact of the Proposed Rule will be influenced by future cross-border rulemakings, as well as the scope and implementation timelines associated with any related rules adopted by other jurisdictions.

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

The Commission nevertheless believes that the proposed rule's approach is necessary and appropriately tailored, consistent with CEA section 2(i) and principles of international comity, to ensure that the regulatory objectives of the Dodd-Frank registration requirements and external business conduct standards are preserved while still establishing a workable approach that recognizes foreign regulatory interests and minimizes competitive disparities and market inefficiencies to the degree possible. Furthermore, as mentioned above, the Commission expects to apply the definitions and classification scheme for market participants resulting from the proposed rule in future cross-border rulemakings; having a uniform set of definitions should mitigate the costs of cross-border compliance with the Dodd-Frank swap regime in the long run.

In the sections that follow, the Commission discusses the costs and benefits associated with the proposed rule, as well as reasonable alternatives. Section 1 begins by addressing the assessment costs associated with the rule, which derive in part from the defined terms used in the proposed rule (the proposed definitions of ''U.S. Person'' and ''Foreign Consolidated Subsidiary,'' as well as the definition of ''guarantee'' adopted in the Cross-Border Margin Rule) and which, as mentioned above, are expected to be relevant outside the context of the cross-border application of the registration thresholds. Sections 2 and 3 consider the costs and benefits associated with the proposed rule's determinations regarding how each classification of market participants (U.S. Persons, U.S. Guaranteed Entities, FCSs, and Other Non-U.S. Persons) should apply to the SD and MSP registration thresholds, respectively. Sections 4, 5, and 6 address the monitoring, registration, and programmatic costs associated with the proposed cross-border approach to the SD (and, as appropriate, MSP) registration thresholds, respectively. Section 7 addresses the costs and benefits associated with the proposed cross-border approach to the external business conduct standards, while Section 8 discusses the factors established in section 15(a) of the CEA. Discussion of the Commission's cost-benefit considerations concludes with an Appendix providing an estimate of the number of new SDs that are expected to register as a result of the Proposed Rule as well as the number of currently registered non-U.S. SDs that the Commission estimates would be classified as FCSs.

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

1. Assessment Costs

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

[140] The Commission's discussion of programmatic costs and registration costs does not address MSPs. No entities are currently registered as MSPs, and the Commission does not expect that this status quo would change as a result of the Proposed Rule given the general similarities between the Proposed Rule's approach to the MSP registration threshold calculations and the Guidance. For an estimate of the number of market participants that may be required to register as SDs as a result of the Proposed Rule, see the accompanying Appendix below.

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

Entity, or an Other Non-U.S. Person. This classification scheme is also generally applicable in the context of the proposed approach to the external business conduct standards,[142] and the Commission further expects to rely on a similar classification scheme in the context of future rulemakings relating to the cross-border application of other substantive Dodd-Frank requirements.

The Commission expects that the costs to affected market participants of assessing which classification they and their counterparties fall into would generally be marginal 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,'' ''Foreign Consolidated Subsidiary,'' and ''guarantee'') or the Guidance (which interprets ''U.S. person'' in a manner that is similar but not identical to the proposed definition of ''U.S. person''). Additionally, the proposed rule would allow market participants to rely on representations from their counterparties with regard to their classifications.[143]

Even with respect to market participants that have not previously determined their status under the Cross-Border Margin Rule or the Guidance, or that may need to reevaluate their status, the Commission believes that their assessment costs would be small as a result of the Proposed Rule's reliance on relatively clear, objective definitions of the terms ''U.S. person,'' ''Foreign Consolidated Subsidiary,'' and ''guarantee.'' Specifically, the Commission believes that the costs of assessing whether a market participant is a ''U.S. person'' would be small as a result of certain key differences between the Proposed Rule's U.S. person definition and the ''U.S. person'' interpretation in the Guidance.[144] Similarly, with respect to the determination of whether a market participant falls within the ''Foreign Consolidated Subsidiary'' definition,[145] the Commission believes that assessment costs would be small as the definition relies on a familiar consolidation test already used by affected market participants in preparing their financial statements under U.S. GAAP.[146]

Additionally, the proposed rule relies on the definition of ''guarantee'' provided in the Cross-Border Margin Rule, which is limited to arrangements in which one party to a swap has rights of recourse against a guarantor with respect to its counterparty's obligations under the swap.[147] Although non-U.S. persons that are not FCSs will need to know whether they are U.S. 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 will already be known by non-U.S. persons.[148] Accordingly, the Commission believes that the costs associated with assessing whether an entity or its counterparty is a U.S. Guaranteed Entity (for the purpose of the registration calculations or any subsequent rulemakings) would be small.

Finally, the Commission believes that proposing consistent U.S. person and Foreign Consolidated Subsidiary definitions, which would apply across all of the Commission's future cross-border rulemakings (unless the specific rule or regulation otherwise provides or the context otherwise requires), would also further reduce costs (including assessment costs) over time by applying a consistent definition across all of the Commission's cross-border swaps rules.[149]

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

a. U.S. Persons and U.S. Guaranteed Entities

Under the proposed rule, a U.S. person would include all of its swap dealing transactions in its de minimis calculation, without exception. As discussed above, that would include any swap dealing transactions conducted through a U.S. person's foreign branch, as such swaps are directly attributed to, and therefore impact, the U.S. person. Given that this requirement mirrors the Guidance in this respect, the Commission believes that the proposed rule would have a minimal impact on the status quo with regard to the number of registered or potential U.S. SDs.[150]

The proposed rule would also require U.S. Guaranteed Entities (that are not FCSs) [151] to include all of their dealing transactions in their de minimis threshold calculation without exception. This approach, which recognizes that a U.S. Guaranteed Entity's swap dealing transactions may have the same potential to impact the U.S. financial system as a U.S. person's dealing transactions, closely parallels the approach taken in the Guidance with respect to ''guaranteed affiliates.'' [152] However, as explained in

[142] The proposed rule's cross-border application of the external business conduct standards would also require SD/MSPs to determine whether a swap is a transaction through a foreign branch. *See* section VI, *supra.*

[143] The Commission believes that these assessment costs for the most part have already been incurred by potential SD/MSPs as a result of adopting policies and procedures consistent with the Guidance and Cross-Border Margin Rule (which had similar classifications), both of which permitted counterparty representations.

[144] As discussed further in section II.A, the proposed U.S. person definition does not include the U.S. majority-owned funds prong that was included in the U.S. person interpretation in the Guidance, which should lower assessment costs. The proposed definition also includes a modified version of the unlimited U.S. responsibility prong in the Guidance, which applied only to legal entities whose unlimited U.S. owners were majority owners. Removing the majority ownership requirement from the unlimited U.S. responsibility prong may lower assessment costs, as compared to the Guidance. Additionally, the Proposed Rule also makes clear that the ''U.S. person'' definition does not capture international financial institutions. Further, the proposed definition does not include the catchall provision that was included in the Guidance, which should further increase legal certainty and reduce assessment costs.

[145] The ''Foreign Consolidated Subsidiary'' definition is discussed further in section II.B.

[146] The Commission also considered certain alternatives to the proposed FCS definition—such as relying on International Financial Reporting Standards in addition to or instead of U.S. GAAP or including a non-U.S. person whose U.S. parent meets standards for consolidation, but does not prepare consolidated financial statements under U.S. GAAP—but believes these alternatives add complexity, without any substantial benefits.

[147] *See* note 79, *supra.*

[148] 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.

[149] The Commission recognizes that this benefit would not be fully realized until such future rulemakings are adopted.

[150] As discussed in the Appendix, 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). As further explained in the Appendix, the Commission does not expect an increase in the number of SDs resulting from the Proposed Rule's definition of U.S. person and therefore assumes that no new U.S. SDs would register as U.S. SDs as a result of the Proposed Rule.

[151] In order to avoid double counting, in the event that the swap of an FCS is guaranteed by a U.S. person, the swap would only be counted under the provision of the Proposed Rule that applies to FCSs. *See* proposed rule § 1.3(ggg)(7)(i)(B) and (C).

[152] 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* the Guidance at 45320. In contrast, the term ''guarantee'' in this proposed rulemaking has the same meaning as defined in Commission regulation 23.160(a)(2) (cross-border application of the Commission's margin requirements for uncleared

Continued

the accompanying Appendix, the Commission believes that there are few U.S. Guaranteed Entities at this time.[153] Accordingly, the Commission believes that, in this respect, any increase in costs associated with the Proposed Rule would be small.

b. Foreign Consolidated Subsidiaries

Under the proposed rule, a Foreign Consolidated Subsidiary would include all of its swap dealing transactions in its de minimis threshold calculation without exception. The Guidance did not differentiate FCSs from Other Non-U.S. Persons, and therefore FCSs would generally only include in their de minimis threshold calculations their swap dealing transactions with U.S. persons (excluding foreign branches of U.S. SDs) and with certain guaranteed affiliates.[154]

However, as noted in section II.B, the Commission believes that it would be appropriate to distinguish FCSs from Other Non-U.S. Persons in determining the cross-border application of the SD de minimis threshold to such entities, as well as with respect to the Dodd-Frank swap provisions more generally. As discussed above, by virtue of the close integration between the FCS and its U.S. ultimate parent, counterparties look to both the FCS and its U.S. parent for fulfillment of the FCS's obligations under the swap, even without any explicit guarantee. Therefore, the Commission believes that it is appropriate to require FCSs to include all of their swap dealing transactions in their SD de minimis calculation. In addition, allowing an FCS to exclude non-U.S. swap dealing transactions from its calculation could incentivize U.S. financial groups to book their non-U.S. dealing transactions into an FCS, avoiding swap regulation.

Under the Proposed Rule, the FCS definition is used to distinguish non-U.S. persons with a U.S. ultimate parent entity from Other Non-U.S. Persons for purposes of determining how Dodd-Frank swap provisions should apply. The full market impact of the Proposed Rule's shift of some non-U.S. persons to FCSs cannot be determined at this time in the absence of further rulemakings addressing the cross-border application of substantive requirements under the Dodd-Frank Act. However, to the extent that future cross-border rulemakings apply more stringent requirements to swap transactions with FCSs, non-U.S. counterparties may seek to avoid transacting with such dealers, fragmenting swaps market liquidity into two pools—one for U.S. persons and FCSs and the other for non-U.S. persons (that are not FCSs). Nevertheless, as discussed above, the Commission believes that the proposal to require FCSs to include all of their swap dealing activity in their de minimis threshold calculations is necessary and appropriate to ensure the policy objectives of the Dodd-Frank Act are preserved and not undermined by a substantial regulatory loophole.

c. Other Non-U.S. Persons

Under the proposed rule, Other Non-U.S. Persons would be required to include in their de minimis threshold calculations swap dealing activities with U.S. persons (including foreign branches of U.S. SDs), U.S. Guaranteed Entities, and FCSs. The proposed rule would not, however, require Other Non-U.S. Persons to include swap dealing transactions with Other Non-U.S. Persons. Additionally, Other Non-U.S. Persons would not be required to include in their de minimis calculation any transaction that is executed anonymously on a SEF, DCM, or FBOT and cleared.

The Commission believes that requiring Other 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 SD registration regime, which focuses on U.S. market participants and the market. As discussed above, the Commission considered incorporating an exception from the Guidance allowing non-U.S. persons to exclude from their de minimis thresholds transactions with foreign branches of U.S. SDs but determined that, given the integral nature of the foreign branch to a U.S. person, such an exception would create a potentially significant regulatory loophole, allowing a substantial amount of dealing activity with U.S. counterparties to occur outside the comprehensive Dodd-Frank swap regime.

Under the proposed rule, Other Non-U.S. Persons would not be required to include any swap dealing transactions with Other Non-U.S. Persons in their SD de minimis threshold calculations, including ANE transactions. Although a non-U.S. person that engages in ANE transactions is performing dealing activity in the United States, the Commission does not believe that requiring non-U.S. persons to include ANE transactions in their de minimis threshold calculations would be necessary to advance the policy objectives of the Dodd-Frank swap regime when taking the Proposed Rule in context, particularly the proposal to require FCSs to include all of their swap dealing transactions in their de minimis threshold calculations.

The Commission recognizes that the proposed rule's cross-border approach to the de minimis threshold calculation could contribute to competitive disparities arising between U.S.-based financial groups and non-U.S. based financial groups. Potential SDs that are U.S. persons or that have a U.S. ultimate parent entity (FCSs) would be required to include all of their swap transactions. In contrast, potential non-U.S. SDs with a non-U.S. ultimate parent entity whose obligations under the relevant swap are not subject to a U.S. guarantee (Other Non-U.S. Persons) would be permitted to exclude swaps with Other Non-U.S. Persons, including ANE transactions. As a result, potential SDs with a U.S. ultimate parent entity may be at a competitive disadvantage, as more of their swap activity would apply toward the de minimis threshold and trigger the SD registration threshold relative to Other Non-U.S. Persons. To the extent that a currently unregistered non-U.S. person would be required to register as an SD under the proposed rule, its non-U.S. counterparties (clients and dealers) may possibly cease transacting with it in order to operate outside the Dodd-Frank swap regime.[155] Additionally, unregistered non-U.S. dealers may be able to offer swaps on more favorable terms to non-U.S. counterparties than U.S. competitors (*i.e.,* U.S. SDs, FCSs,

swaps), except that application of the proposed definition of ''guarantee'' would not be limited to uncleared swaps. *See* note 79, *supra.*

[153] The proposed rule would require U.S. Guaranteed Entities that are not FCSs to include all of their dealing transactions in their de minimis calculation. However, the Commission believes that there are few U.S. Guaranteed Entities (that are not FCSs). The Commission notes that the Proposed Rule uses a narrower definition of guarantee (compared to the Guidance), which would result in relatively fewer U.S. Guaranteed Entities than if a broader definition were used. In addition, the Commission believes that, as a practical matter, few non-U.S. persons that are not FCSs obtain guarantees of their obligations under swaps (which would generally need to be obtained from an unaffiliated U.S. person). Although the Commission believes that there are few U.S. Guaranteed Entities at this time, the Commission has covered this infrequent situation in the Proposed Rule as a prophylactic measure.

[154] The Commission believes that some FCSs would have been ''guaranteed affiliates'' as described in the Guidance at the time that it was initially issued, but the Commission understands that many financial groups ceased providing guarantees with regard to their affiliated entities' swap activities subsequent to the issuance of the Guidance, such that FCSs would have adopted policies and practices consistent with the Guidance's treatment of non-U.S. persons (that are not guaranteed or conduit affiliates).

[155] 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 effect on competition and liquidity.

and U.S. Guaranteed Entities) because they are not required to register (and therefore would not be subject to the Dodd-Frank swap dealer regime).[156] As noted above, however, the Commission believes that these competitive disparities would be mitigated to the extent that foreign jurisdictions impose comparable requirements. Furthermore, the Commission reiterates its belief that the cross-border approach to the SD registration threshold taken in the Proposed Rule is appropriately tailored to further the policy objectives of the Dodd-Frank Act while mitigating unnecessary burdens and disruption to market practices to the extent possible.

3. Cross-Border Application of the Major Swap Participant Registration Thresholds

As described in section V, the Proposed Rule would approach the cross-border application of the MSP registration thresholds in a similar manner as the SD de minimis registration threshold. Specifically, the proposed rule would require U.S. persons, U.S. Guaranteed Entities, and FCSs to include all of their swap positions in their MSP calculations without exception. As further explained in section V, in the Commission's view this result is appropriate because the Commission believes that swap positions with U.S. persons, U.S. Guaranteed Entities, and FCSs can in each case have a significant effect on the U.S. financial system and therefore should be treated in a similar manner for purposes of the MSP registration calculation.

For related reasons discussed in section V.B, the proposed rule would also require Other Non-U.S. Persons to include in their MSP calculations all of their swap positions with U.S. persons, U.S. Guaranteed Entities, and FCSs, with a limited exception for transactions executed anonymously on a SEF, DCM, or FBOT and cleared. The Commission believes that swap positions with U.S. persons, U.S. Guaranteed Entities, and FCSs can in each case have a significant effect on the U.S. financial system and therefore should be treated in a similar manner.[157] Other Non-U.S. Persons would not, however, be required to include swap positions with Other Non-U.S. Persons in their MSP calculations, as the Commission does not believe these swaps would present the type of risk to the U.S. financial system that the MSP definition and registration requirements are intended to address.

The Commission notes that no entities are currently registered as MSPs. The Commission also does not believe that the proposed cross-border approach to the MSP registration thresholds would result in significant costs to market participants compared to the status quo (*i.e.,* would not cause any market participants to register as MSPs) given the general similarities between the proposed rule's approach to the MSP registration threshold calculations and the corollary approach provided in the Guidance.[158]

4. Monitoring Costs

Under the proposed rule, market participants would need to continue to monitor their swap activities in order to determine whether they are, or continue to be, required to register as an SD or MSP. Given that market participants are believed to have developed policies and practices consistent with the cross-border approach to the SD/MSP registration thresholds expressed in the Guidance, the Commission believes that market participants would only incur incremental costs in modifying their existing systems and policies and procedures in response to the proposed rule (*e.g.,* determining which swaps activities or positions would be required to be included in the registration threshold calculations).[159]

For example, the Commission notes that FCSs are likely to have adopted policies and practices in line with the Guidance 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.[160] Although an FCS would be required under the proposed rule to include all swaps connected with its dealing activities in its de minimis calculation, without exception, the Commission believes that any increase in monitoring costs for FCSs would be de minimis, 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.[161]

5. Registration Costs

As a result of the proposed rule's classification scheme for market participants (*e.g.,* as U.S. persons, FCSs, U.S. Guaranteed Entities, and Other Non-U.S. Persons, as described above) and the proposed requirement that they apply the SD registration threshold accordingly, the Commission recognizes that some market participants would be required to register as SDs with the Commission who were previously not required to register. In considering the costs and benefits of the proposed rule, the Commission has estimated that approximately 14 unregistered non-U.S. persons may be required to register as SDs as a result of the proposed rule. The basis for this estimated increase in the number of SDs is discussed below in the accompanying Appendix. The Commission previously estimated registration costs in its rulemaking on registration of SDs;[162] however, the costs that may be incurred should be mitigated to the extent that these new SDs are affiliated with an existing SD, as most of these costs have already been realized by the consolidated group. 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

[156] 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.

[157] In addition, the Commission considered whether to include an exclusion similar to that discussed in the Guidance (which provides that non-U.S. persons that are not ''guaranteed affiliates'' generally could exclude from their MSP threshold calculations swap positions with either a foreign branch of a U.S. SD or a guaranteed affiliate that is an SD if either (i) the potential non-U.S. MSP is a non-financial entity or (ii) the potential non-U.S. MSP is a financial entity *and* the swap is either cleared or the swap documentation requires the foreign branch or guaranteed affiliate to collect daily variation margin with no threshold). Although including corollary exclusions in the Proposed Rule might result in reduced compliance costs, the Commission preliminarily believes that such exclusions are unnecessary and inappropriate for the reasons discussed above. *See* note 106, *supra.* The Commission further does not believe that the decision not to include such an exception would result in any new MSPs. The Commission is also seeking comment in section V with regard to whether to adopt the SEC approach of not requiring a non-U.S. person to include in its MSP threshold calculations any swap positions for which they (as opposed to the non-U.S. person's counterparty) benefit from a guarantee creating a right of recourse against a U.S. person. *See* note 113, *supra,* and accompanying text.

[158] *See also* note 157, *supra.*

[159] Although the cross-border approach to the MSP registration threshold calculation in the Proposed Rule is not identical to the approach included in the Guidance, *see* note 106, *supra,* the Commission believes that any resulting increase in monitoring costs resulting from the Proposed Rule would be incremental and de minimis.

[160] Although the Guidance provided that non-U.S. persons (that are not guaranteed or conduit affiliates) should generally include all of their swap dealing transactions with U.S. persons (excluding foreign branches of a U.S. SD) as well as swaps with certain guaranteed affiliates in their de minimis threshold calculations, the Commission understands that at the current time guaranteed affiliates, as defined in the Guidance, likely no longer exist or are few in number.

[161] *See* section VII.C.1, *supra,* for a discussion of assessment costs.

[162] *See* Registration of Swap Dealers and Major Swap Participants, 77 FR 2613, 2623–25 (Jan. 19, 2012).

register as an MSP under the Proposed Rule, as noted above.

6. Programmatic Costs

As noted above, if the proposed rule is adopted, certain market participants would likely be required to register as SDs and would become subject to various requirements imposed on swap dealers under the Dodd-Frank Act and related Commission's regulations. To the extent that the proposed rule acts as a ''gating'' rule by affecting which entities engaged in cross-border swaps activities must comply with the SD requirements, the Proposed Rule could result in increased costs for particular entities that otherwise would not register as an SD and comply with the swap provisions.[163]

Market participants that are already registered (or provisionally registered) as SDs or MSPs prior to adoption of the proposed rule (if it is adopted) could also be affected by the proposal. In particular, the Commission is proposing rules that would define certain key terms for purposes of the Dodd-Frank swaps provisions (including future cross-border rulemakings). Therefore, the proposal could affect the treatment of market participants that are already registered (or provisionally registered) across the Commission's entire cross-border framework and attendant costs and benefits in addition to those that are registering for the first time. The proposal also addresses the cross-border application of the Commission's external business conduct standards, including the extent to which such requirements would apply to swap transactions that are arranged, negotiated, or executed by registered SDs or MSPs using personnel located in the United States.

Further, as a result of the proposed rule, certain other market participants would be categorized differently under the proposal than they were under the Guidance, which could affect how they are treated across the Commission's entire cross-border framework and attendant costs and benefits.[164] Although the exact treatment of market participants across the Commission's cross-border framework is not set out in this proposal, the Commission will address specific costs that market participants will incur in each specific future rulemaking.

7. Cross-Border Application of External Business Conduct Requirements

As discussed in section VI above, the proposed rule addresses the cross-border application of the Commission's external business conduct standards to transactions in which at least one of the counterparties is an SD/MSP, including the extent to which they would apply to ANE transactions. Under the proposed rule, U.S. SD/MSPs (other than foreign branches of U.S. SD/MSPs) would be required to comply with the Commission's external business conduct standards without substituted compliance. As discussed above, this requirement reflects the Commission's view that the Dodd-Frank external business conduct standards should apply fully to registered SDs and MSPs domiciled and operating in the United States because their swap activities are particularly likely to affect the integrity of the swaps market in the United States and raise concerns about the protection of participants in those markets. The Commission does not expect that this requirement would impose any additional costs on market participants in comparison to the status quo given that the Commission's external business conduct standards already apply to U.S. SD/MSPs under the Commission's external business conduct standards rulemaking.[165]

Non-U.S. SD/MSPs and foreign branches of U.S. SD/MSPs would only be required to comply with the external business conduct standards if (1) the counterparty is a U.S. person (other than a foreign branch of a U.S. SD/MSP) or (2) a non-U.S. SD or foreign branch of a U.S. SD uses personnel located in the United States to arrange, negotiate, or execute the transaction (or a swap that is offered but not entered into), in which case the antifraud [166] and fair dealing [167] requirements would apply. The proposal to require non-U.S. SD/MSPs and foreign branches of U.S. SD/MSPs to comply with the external business conduct standards where the counterparty is a U.S. person (other than a foreign branch of a U.S. SD/MSP) reflects the Commission's recognition that the Dodd Frank Act's counterparty protection mandate focuses on protecting U.S. market participants, such that the external business requirements should apply fully to U.S. persons without substituted compliance regardless of the location from which the SD/MSP may be operating. The exception for counterparties that are foreign branches of U.S. SD/MSPs reflects the Commission's belief that, even though the foreign branch is an integral part of the U.S. SD/MSP, a foreign regulatory regime may have a heightened interest in enforcing its own sales practice requirements to transactions occurring within its jurisdiction. Furthermore, this limited exception should reduce competitive disparities between such foreign branches and FCSs when transacting with non-U.S. clients. Again, the Commission does not expect that, in this regard, the proposed rule would impose any additional costs on market participants in comparison to the status quo, particularly given that the proposed rule does not significantly deviate from the Commission's existing cross-border policy in this respect, as described in the Guidance.[168]

The proposed rule goes beyond the scope of the Guidance, however, by making clear that non-U.S. SDs and foreign branches of U.S. SDs would be required to comply with the antifraud and fair dealing external business conduct standards with respect to ANE transactions. This requirement would therefore impose additional compliance costs relative to the status quo not only on existing non-U.S. SDs and foreign branches of U.S. SDs, which likely currently do not comply with the external business conduct standards with respect to their transactions with non-U.S. persons or foreign branches of U.S. SD/MSPs, but any non-U.S. persons that are required to register by virtue of the proposed rule's approach to the SD registration threshold. As discussed above, where swaps are arranged, negotiated or executed in the United States, the Commission has a strong supervisory interest both in protecting involved counterparties against fraud, manipulation and other abusive practices of an SD and in requiring that the SD communicate in a fair and balanced manner with these counterparties based on principles of fair dealing and good faith. Taking the proposed rule as a whole, however, the Commission does not believe that application of the remaining external business conduct standards would be necessary to advance the goals of the

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

[164] As discussed below in the accompanying Appendix, the Commission has estimated that out of a total of 54 provisionally registered non-U.S. SDs entities, 17 would be classified as an FCS under the Proposed Rule.

[165] *See* Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 77 FR 9734 (Feb. 17, 2012). The Commission's discussion of cost-benefit considerations is at 77 FR at 9805–22.

[166] *See* 17 CFR 23.410.

[167] *See* 17 CFR 23.433.

[168] Under the approach described in the Guidance, non-U.S. SD/MSPs and foreign branches of U.S. SD/MSPs generally would not comply with the business conduct standards to the extent that their counterparty is a foreign branch of a U.S. SD/MSP or a non-U.S. person.

Dodd-Frank Act. Accordingly, by limiting application of the external business conduct standards to ANE transactions to the antifraud and fair dealing requirements, the Proposed Rule is appropriately tailored to ensure a basic level of counterparty protections while, consistent with the principles of international comity, recognizing the supervisory interests of the relevant foreign jurisdictions in applying their own sales practices requirements to transactions involving counterparties that are non-U.S. persons (or foreign branches of U.S. SD/MSPs) and avoiding potentially unnecessarily duplicative requirements.

8. Section 15(a) Factors

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

a. Protection of Market Participants and the Public

The Commission believes the proposed rule would support protection of market participants and the public. By focusing on and capturing swap dealing transactions and swap positions involving U.S. persons and non-U.S. persons with a strong nexus to the United States (*e.g.,* FCSs and U.S. Guaranteed Entities), the Proposed 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 objectives of the Dodd-Frank Act, significant participants in the U.S. market are subject to the CEA's swap regime. The proposed cross-border approach to the external business conduct standards, including applying the antifraud and fair dealing requirements to ANE transactions, similarly ensures that the Dodd-Frank market protections 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 sales practices requirements to transactions involving non-U.S. SD/MSPs and foreign branches of U.S. SD/MSPs with non-U.S. persons and foreign branches of U.S. SD/MSPs.

b. Efficiency, Competitiveness, and Financial Integrity of the Markets

To the extent that the proposed rule leads additional entities to register as SDs, the Commission believes that the proposed rule could enhance the financial integrity of the markets by bringing significant U.S. swaps 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 Proposed Rule's cross-border approach to the SD and MSP registration thresholds may create competitive disparities among market participants, based on the degree of their connection to the United States, that could contribute to market inefficiencies, 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 (or in the case of swaps, the cost of the swap and the cost to hedge). Such competitive effects and market inefficiencies 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. On balance, the Commission believes that the proposed rule's approach is necessary and appropriately tailored to ensure that the purposes of the Dodd-Frank swap regime and its registration requirements are advanced while still establishing a workable approach that recognizes foreign regulatory interests and minimizes competitive disparities and market inefficiencies to the degree possible. The Commission further believes that the proposed rule's cross-border approach to the external business conduct standards will promote the financial integrity of the markets by fostering transparency and confidence in the major participants in the U.S. swap markets.

c. Price Discovery

The Commission recognizes that the proposed rule's approach to the cross-border application of the SD and MSP registration thresholds could also have an effect on liquidity, which may in turn influence price discovery. As liquidity in the swaps 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 obtain the 'true' price of a swap may be hindered. However, as noted above, these negative effects would be mitigated as jurisdictions harmonize their swaps initiative and global financial institutions continue to manage their swaps 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 proposed rule's approach to the external business conduct standards, however, will have a measurable impact on price discovery.

d. Sound Risk Management Practices

The Commission believes that the proposed rule's approach could promote the development of sound risk management practices by ensuring that significant participants in the U.S. market are subject to Commission oversight (via registration), including in particular important counterparty disclosure and recordkeeping requirements that will encourage policies and practices that promote fair dealing while discouraging abusive practices in U.S. markets.

e. Other Public Interest Considerations

The Commission has not identified any public interest considerations related to the costs and benefits of the proposed rule.

Request for Comment. The Commission invites comment on all aspects of the costs and benefits associated with the proposed rule, including the following:

1. Is the Commission's assumption that few, if any, market participants will be required to register as MSPs as a result of the proposed rule (as compared to the status quo) correct? If not, please provide an estimate of the number of market participants that are likely to have to register as MSPs as a result of the proposed rule, including an explanation for the basis of the estimate, and associated costs and benefits of the Proposed Rule's provisions for MSPs (including potential MSPs).

2. The Commission preliminarily believes that a requirement that Other Non-U.S. Persons include ANE transactions in their SD registration threshold calculations would not be likely to increase the scope of entities that would be covered under its swap requirements, but may result in significant burdens. Is that belief correct? If not, please provide an

estimate of the potential costs and benefits associated with including such a requirement?

3. The Commission invites information regarding whether and the extent to which specific foreign requirement(s) may affect the costs and benefits of the proposed rule, including information identifying the relevant foreign requirement(s) and any monetary or other quantitative estimates of the potential magnitude of those costs and benefits.

4. The Commission is estimating that 17 currently registered non-U.S. SDs would be classified as FCSs and that 14 unregistered non-U.S. persons may be classified as FCSs and required to register as new SDs because their swap dealing transactions are in excess of the SD de minimis threshold. The basis for these estimates is set forth below in the accompanying Appendix. The Commission seeks comments regarding its estimates of the scope and number of market participants potentially affected by the proposed rule, including its methodology for arriving at the estimates in the Appendix to Cost Benefit Considerations.

9. Appendix to Cost-Benefit Considerations

In this Appendix, the Commission explains its methodology for estimating, as a result of the proposed rule, the number of new entities that may be required to register with the Commission as SDs and the number of currently registered non-U.S. SDs that would be classified as an FCS. In arriving at this estimate, the Commission relied on SDR data and other data sources.[169] However, the Commission faced a number of challenges in conducting a quantitative analysis. In particular, the Commission does not have SDR data on trades between two non-U.S. persons, and its estimate with regard to the number of non-U.S. persons that may be required to register as SDs by virtue of being FCSs is based on certain assumptions and adjustments, as explained further below.

a. Estimates Regarding U.S. Persons and U.S. Guaranteed Entities

The Commission is estimating that overall there will not be an increase in the number of persons that will be required to register as U.S. SDs as a result of the proposed rule, as the proposed rule's approach to the swaps of U.S. persons mirrors the approach in the Guidance (*i.e.,* all swap dealing transactions must be included). Furthermore, the Commission does not expect any increase in the number of SDs resulting from changes to the U.S. person definition.[170]

The Commission is also estimating that there will be no increase in the number of new SDs that are U.S. Guaranteed Entities, as the proposed rule uses a narrower definition of a guarantee (compared to the Guidance), which the Commission believes will result in few, if any, U.S. Guaranteed Entities.[171] Therefore, for purposes of this cost-benefit analysis, the Commission estimates that currently there are no U.S. Guaranteed Entities (that are not FCSs) with over $8 billion in swaps dealing transactions.

b. Estimates Regarding Foreign Consolidated Subsidiaries

If the proposed rule is adopted, the Commission estimates that 17 currently registered non-U.S. SDs would be classified as FCSs and that 14 unregistered non-U.S. persons may be classified as FCSs and required to register as new SDs because their swap dealing transactions are in excess of the SD de minimis threshold. The basis for these estimates is set forth below.

(1) Estimate of the Number of Non-U.S. Swap Dealers That Would Be Classified as FCSs

In estimating the number of SDs that, as a result of the proposed rule, would shift from a category of non-U.S. SDs to the new category, FCS, the Commission reviewed its current list of registered SDs. As the definition of an FCS is dependent on whether the SD is a non-U.S. person that has an ultimate U.S. parent entity, the Commission was able to isolate those entities from a list of non-U.S. SDs. From this list, the Commission estimated that out of a total of 54 provisionally registered non-U.S. SDs, 17 would be classified as an FCS under the proposed rule.

(2) Estimate of Potential FCSs That May Be Required To Register as Swap Dealers

The Commission estimates that approximately 14 unregistered non-U.S. persons with a U.S. ultimate parent entity under U.S. GAAP (''potential FCSs'') may be required to register as SDs as a result of the proposed rule. The Commission does not currently collect data on trades between non-U.S. persons (including those of potential FCSs with non-U.S. persons). Therefore, in estimating the number of potential FCSs that may be required to register as SDs, the Commission relied on SDR data regarding inter-affiliate trades between potential FCSs and their affiliated U.S. SDs (''inter-affiliate trades'').

The Commission believes that SDR data on inter-affiliate trades provide a reasonable basis upon which to estimate the outward-dealing trades of potential FCSs with non-U.S. persons, provided that the estimate is scaled to the global swap market (as detailed below).[172] As described in section I.B, global financial groups commonly carry out swap dealing activities in multiple jurisdictions through branches or affiliates that effectively operate as a single business under the control of the ultimate parent entity. Under this model, where a non-U.S. branch or affiliate in the global financial group enters into a swap with a non-U.S. client in a local market, it will then offset the risk associated with the outward-facing swap via an inter-affiliate swap, which is likely to be with an affiliated dealer or market maker in the particular swap in the group.[173]

[169] Additional sources are referenced below. *See* note 174, *infra.*

[170] There may be a decrease in the number of funds or other entities that fall within the U.S. person definition as compared to the Guidance because the proposed U.S. person definition does not include the U.S. majority-owned funds provision or the catchall provision that were included in the U.S. person interpretation in the Guidance, and the Commission is clarifying that the proposed definition does not capture international financial institutions. On the other hand, because the unlimited U.S. responsibility prong does not include a majority ownership requirement (in a modification from the Guidance), this could increase the number of entities that fall within the U.S. person definition resulting in a concomitant increase in the number of SDs as compared to the Guidance. In addition, the Commission is not providing a safe harbor for funds that are only solicited to non-U.S. persons, which is a difference from the policy discussed in the Guidance. Therefore, overall the Commission does not expect any increase in the number of SDs resulting from changes to the U.S. person definition.

[171] As explained in the preamble, the Commission believes that there are few U.S. Guaranteed Entities at this time. *See* note 153, *supra.* Accordingly, the Commission does not expect an increase in the number of new SDs that would be required to register as a result of the Proposed Rule's requirement that a U.S. Guaranteed Entity include all of its swaps in its SD de minimis calculation.

[172] The Commission is unable to quantify certain swaps that may fall under the Proposed Rule. Specifically, there are dealing transactions entered into by potential FCSs with non-U.S. counterparties that would be included in the SD de minimis calculation of potential FCSs in this rulemaking that are not reported. Therefore, an estimate based solely on the SDR data for inter-affiliate trades would be under-inclusive because it only covers inter-affiliate trades between potential FCSs and their affiliated U.S. SDs. Accordingly, as detailed below, the Commission has scaled the inter-affiliate trade data to the global swaps market.

[173] The Commission understands that risk may move in either direction in an inter-affiliate trade, and therefore, the Commission's use of SDR data on inter-affiliate trades between a potential FCS and an affiliated U.S. SD may also be over-inclusive in estimating the number of SDs. However, for the reasons discussed in this section, the Commission believes that SDR data on potential FCSs' inter-

Accordingly, the Commission believes that inter-affiliate trades provide a reasonable means of estimating a substantial portion of a potential FCS's outward-facing swap dealing with non-U.S. counterparties.

However, there is an important limitation on the use of this inter-affiliate data which is likely to cause it to be under-inclusive as a proxy for the outward-facing trades of these potential FCSs with non-U.S. persons, as the Commission's SDR data only includes swaps that are between a potential FCS and an affiliated U.S. SD. Potential FCSs may also transfer the risk of some of their outward-facing dealing activities to affiliated non-U.S. SDs located in market centers outside the United States (*e.g.,* London and Tokyo) or retain the risk in their dealer portfolio (and an FCS must count all of its outward-facing dealing transactions toward its SD de minimis threshold under the proposed rule). Consequently, the Commission believes that using SDR data on inter-affiliate trades (which only includes a potential FCS's inter-affiliate swaps with an affiliated U.S. SD) as a proxy for swap dealing between a potential FCS and non-U.S. persons is likely to be under-inclusive. Therefore, the Commission has scaled the SDR data on inter-affiliate trades between a potential FCS and an affiliated U.S. SD to the global swaps market by applying a factor of 2 (which represents the approximate ratio between total U.S. swaps market and that of the global swaps market),[174] in order to estimate the number of potential FCSs that may be required to register as SDs as a result of the proposed rule.

Based on the foregoing assumptions, the Commission obtained SDR data on inter-affiliate swaps for each potential FCS with affiliated U.S. SDs during the period between March 5, 2015 and March 4, 2016 (the ''Reference Period''). Because this inter-affiliate trade data only includes open trades as of the end of the Reference Period (*i.e.,* trades that were closed out during the Reference Period are not accounted for in the data), the Commission used a $1 billion notional amount as a screening threshold to identify those potential FCSs that may be required to register as an SD under the proposed rule, rather than the current $8 billion SD de minimis threshold. Seven of the non-U.S. persons identified as potential FCSs had inter-affiliate trades with U.S. SDs that exceeded this $1 billion screening threshold. The Commission then multiplied its estimate of 7 by a scaling factor of 2 (as described above) to estimate that approximately 14 potential FCSs may be required to register as SDs as a result of the proposed rule.

c. Other Non-U.S. Persons

The Commission is unable to estimate the number of new SDs that may be required to register as a result of the proposed rule's requirement that an Other Non-U.S. Person include swaps with an FCS for SD registration threshold purposes due to the lack of SDR data regarding transactions between non-U.S. persons. The Commission also is not estimating the number of new SDs that may be required to register as a result of the proposed rule's requirement that an Other Non-U.S. Person include swaps with a U.S. Person or U.S. Guaranteed Entity in its SD de minimis registration threshold. The Commission believes that few, if any, additional Other Non-U.S. Persons would be required to register as an SD as a result of changes made by the proposed rule (as compared to the Guidance) with respect to either U.S. persons or U.S. Guaranteed Entities.[175]

As noted above, the Commission requests comment regarding its estimates of the scope and number of market participants potentially affected by the proposed rule, including its methodology for arriving at the estimates included in this Appendix.

VIII. Preamble Summary Tables

TABLE A—CROSS-BORDER APPLICATION OF THE SWAP DEALER DE MINIMIS THRESHOLD

[Table A should be read in conjunction with the text of the proposed rule]

Counterparty → / Potential SD ↓	U.S. Person	Non-U.S. person	
		U.S. Guaranteed entity [1]/FCS	Other Non-U.S. person
U.S. Person	Include	Include	Include.
Non-U.S. Person:			
U.S. Guaranteed Entity [1]/FCS	Include	Include	Include.
Other Non-U.S. Person	Include [2]	Include [2]	Exclude.

[1] A non-U.S. person that is a U.S. Guaranteed Entity with respect to a swap would include the swap in its de minimis calculation if its swap counterparty has rights of recourse against a U.S. person with respect to its obligations under the swap.

[2] An Other Non-U.S. Person would include all swaps connected with its dealing activity with counterparties that are U.S. persons, U.S. Guaranteed Entities, or FCSs unless the swap is executed anonymously on a registered SEF, DCM, or FBOT and cleared.

affiliate swaps with affiliated U.S. SDs is much more likely to be under-inclusive as a means of estimating the number of potential FCSs that would be required to register as a result of the Proposed Rule.

[174] The factor of 2 that the Commission is using to scale the data upon which it is basing its estimate to the global swaps market is based on the inverse of the 57% scaling factor used in the cost-benefit analysis for the Commission's Final Margin Rule, rounded up to 2. In the Final Margin Rule, the Commission applied a 57% scale factor to the global notional amount of margin estimated in ISDA and BCBS–IOSCO surveys in order to better align its estimate of the global impact of margin requirements for uncleared swaps with the impact of the U.S. rules. The Commission utilized SDR data on uncleared interest rate swaps, which represent the majority of the notional value associated with uncleared swaps, to compute the 57% scale factor. The 57% scale factor was designed to represent the notional amount of uncleared interest rate swaps reported to the SDRs as a fraction of the global notional amount of uncleared interest rate swaps. *See* Final Margin Rule, 81 FR at 690–91 (Appendix A).

[175] The Commission believes that any increase in the number of Other Non-U.S. SDs that are required to register as an SD as a result of the proposed rule's requirement that an Other Non-U.S. Person include swaps with a U.S. Person in its SD de minimis calculation would be de minimis because the Guidance expresses a similar policy. Under the Guidance, non-U.S. persons that are not guaranteed or conduit affiliates generally include swaps with U.S. persons, excluding foreign branches of U.S. SDS, in their SD de minimis calculation. To the extent this reflects current industry practice, the Commission believes that few, if any, additional Other Non-U.S. Persons would be required to register as SDs as a result of deviation from the Guidance by the proposed rule with regard to counting swaps with U.S. persons.

In addition, as explained in the preamble, the Commission believes that there are few U.S. Guaranteed Entities at this time. *See* note 153, *supra.* Accordingly, the Commission does not expect an increase in the number of new SDs that would be required to register as a result of the proposed rule's requirement that an Other Non-U.S. Person include swaps with a U.S. Guaranteed Entity in its SD de minimis calculation.

Additionally, a potential SD, whether a U.S. or non-U.S. person, would aggregate all swaps connected with its dealing activity with those of persons controlling, controlled by, or under common control with such potential SD to the extent that these affiliated persons are themselves required to include those swaps in their own de minimis thresholds, unless the affiliated person is a registered SD.

TABLE B—CROSS-BORDER APPLICATION OF THE MAJOR SWAP PARTICIPANT REGISTRATION THRESHOLDS

[Table B should be read in conjunction with the text of the proposed rule]

Counterparty → / Potential MSP ↓	U.S. Person	Non-U.S. person	
		U.S. Guaranteed entity [1]/FCS	Other Non-U.S. person
U.S. Person	Include	Include	Include.
Non-U.S. Person:			
U.S. Guaranteed Entity [a]/FCS	Include	Include	Include.
Other Non-U.S. Person	Include [b]	Include [b]	Exclude.

[a] A non-U.S. person that is a U.S. Guaranteed Entity with respect to the relevant swap would include the swap in its MSP threshold calculations if its swap counterparty has rights of recourse against a U.S. person with respect to its obligations under the swap. 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.

[b] An Other Non-U.S. Person would include all of its swap positions with counterparties that are U.S. persons, U.S. Guaranteed Entities, or FCSs unless the swap is executed anonymously on a registered SEF, DCM, or FBOT and cleared.

TABLE C—CROSS-BORDER APPLICATION OF THE EXTERNAL BUSINESS CONDUCT STANDARDS

[Table C should be read in conjunction with the text of the proposed rule]

Counterparty → / Potential SD ↓	U.S. Person		Non-U.S. person
	Not a foreign branch of an SD/MSP	Foreign branch of an SD/MSP	
U.S. Person:			
Not a Foreign Branch	Apply	Apply	Apply.
Foreign Branch	Apply	Do Not Apply *	Do Not Apply.*
Non-U.S. Person	Apply	Do Not Apply *	Do Not Apply.*

* An SD that uses personnel located in the United States to arrange, negotiate, or execute a swap transaction (or a swap that is offered but not entered into) would nevertheless be subject to Commission regulations 23.410 (Prohibition on Fraud, Manipulation, and other Abusive Practices) and 23.433 (Fair Dealing).

List of Subjects

17 CFR Part 1

Counterparties, Cross-border, Major swap participants, Swap dealers, Swaps.

17 CFR Part 23

Business conduct standards, Counterparties, Cross-border, Major swap participants, Swap dealers, Swaps.

For the reasons discussed in the preamble, the Commodity Futures Trading Commission proposes to amend 17 CFR chapter I as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

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

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6l, 6m, 6n, 6o, 6p, 6r, 6s, 7, 7a–1, 7a–2, 7b, 7b–3, 8, 9, 10a, 12, 12a, 12c, 13a, 13a–1, 16, 16a, 19, 21, 23, and 24 (2012).

■ 2. Amend § 1.3 as follows:
■ a. Add paragraphs (ggg)(7) and (nnn);
■ b. Reserve paragraphs (ooo)–(www) and (tttt)–(zzzz); and
■ c. Add paragraph (aaaaa).

The additions to read as follows:

§ 1.3 Definitions.

* * * * *

(ggg) * * *

(7) *Cross-border application of de minimis registration threshold calculation.*

(i) For purposes of determining whether an entity engages in more than a de minimis quantity of swap dealing activity under § 1.3(ggg)(4)(i), a person shall include the following swaps (subject to § 1.3(ggg)(6)):

(A) If such person is a U.S. person, all swaps connected with the dealing activity in which such person engages;

(B) If such person is a Foreign Consolidated Subsidiary, all swaps connected with the dealing activity in which such person engages;

(C) If such person is a non-U.S. person that is not a Foreign Consolidated Subsidiary, and its obligations under the relevant swap(s) are guaranteed by a U.S. person, all swaps connected with the dealing activity in which such person engages as to which its obligations under the relevant swap(s) are guaranteed by a U.S. person (in addition to any swaps that it is required to include pursuant to paragraph (ggg)(7)(i)(D) of this section);

(D) If such person is a non-U.S. person that is not a Foreign Consolidated Subsidiary, and its obligations under the relevant swap(s) are not guaranteed by a U.S. person, all of the following swaps connected with the dealing activity in which such person engages (in addition to any swaps that it is required to include pursuant to paragraph (ggg)(7)(i)(C) of this section) (unless the swap is entered into anonymously on a registered designated contract market, registered swap execution facility, or registered foreign board of trade and cleared through a registered or exempt derivatives clearing organization):

(*1*) Swaps with a counterparty that is a U.S. person;

(*2*) Swaps with a counterparty that is a Foreign Consolidated Subsidiary; and

(*3*) Swaps with a counterparty that is a non-U.S. person that is not a Foreign Consolidated Subsidiary and whose obligations under the relevant swap(s) are guaranteed by a U.S. person.

(ii) [Reserved]

* * * * *

(nnn) *Application of major swap participant tests in the cross-border context.*

(1) For purposes of determining a person's status as a major swap participant as defined in section 1a(33) of the Act, 7 U.S.C. 1(a)(33) and the rules and regulations thereunder, a person shall include the following swap positions:

(i) If such person is a U.S. person, all swap positions that are entered into by the person;

(ii) If such person is a Foreign Consolidated Subsidiary, all swap positions that are entered into by the person; and

(iii) If such person is a non-U.S. person that is not a Foreign Consolidated Subsidiary, and its obligations under the relevant swap(s) are guaranteed by a U.S. person, all swap positions that are entered into by the person as to which its obligations under the relevant swap(s) are guaranteed by a U.S. person (in addition to any swap positions that it is required to include pursuant to paragraph (nnn)(1)(iv) of this section);

(iv) If such person is a non-U.S. person that is not a Foreign Consolidated Subsidiary, and its obligations under the relevant swap(s) are not guaranteed by a U.S. person, all of the following swap positions that are entered into by the person (in addition to any swap positions that it is required to include pursuant to paragraph (nnn)(1)(iii) of this section) (unless the swap position is entered into anonymously on a registered designated contract market, registered swap execution facility, or registered foreign board of trade and cleared through a registered or exempt derivatives clearing organization):

(A) Swap positions with a counterparty that is a U.S. person;

(B) Swap positions with a counterparty that is a Foreign Consolidated Subsidiary; and

(C) Swap positions with a counterparty that is a non-U.S. person that is not a Foreign Consolidated Subsidiary and whose obligations under the relevant swap are guaranteed by a U.S. person.

(2) [Reserved]

(ooo)–(www) [Reserved]

* * * * *

(tttt)–(zzzz) [Reserved]

(aaaaa) *Cross-border definitions.* The following terms, as used in the rules and regulations in this chapter, with respect to the cross-border application of the swap provisions of the Act (or of the rules and regulations in this chapter prescribed or promulgated thereunder), shall have the meanings hereby assigned to them, unless the specific rule or regulation in this chapter otherwise provides or the context otherwise requires:

(1) *Foreign Consolidated Subsidiary* means a non-U.S. person in which an ultimate parent entity that is a U.S. person (''U.S. ultimate parent entity'') has a controlling financial interest, in accordance with U.S. generally accepted accounting principles, 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. generally accepted accounting principles.

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

(3) *Ultimate parent entity* means the parent entity in a consolidated group in which none of the other entities in the consolidated group has a controlling interest, in accordance with U.S. generally accepted accounting principles.

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

(5) *U.S. person* means:

(i) A natural person who is a resident of the United States;

(ii) An estate of a decedent who was a resident of the United States at the time of death;

(iii) 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 (aaaaa)(5)(iv) or (v) of this section) (''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 the legal entity;

(iv) A pension plan for the employees, officers or principals of a legal entity described in paragraph (aaaaa)(5)(iii) of this section, unless the pension plan is primarily for foreign employees of such entity;

(v) A trust governed by the laws of a state or other jurisdiction in the United States, if a court within the United States is able to exercise primary supervision over the administration of the trust;

(vi) A legal entity (other than a limited liability company, limited liability partnership or similar entity where all of the owners of the entity have limited liability) that is owned by one or more persons described in paragraphs (aaaaa)(5)(i) through (v) of this section and for which such person(s) bears unlimited responsibility for the obligations and liabilities of the legal entity, including any branch of the legal entity; or

(vii) An individual account or joint account (discretionary or not) where the beneficial owner (or one of the beneficial owners in the case of a joint account) is a person described in paragraphs (aaaaa)(5)(i) through (vi) of this section.

PART 23—SWAP DEALERS AND MAJOR SWAP PARTICIPANTS

■ 3. 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), Public Law 111–203, 124 Stat. 1641 (2010).

■ 4. Add § 23.452 in subpart H to read as follows:

§ 23.452 Cross-border application.

(a) Except as provided in paragraph (b) of this section, anything else to the contrary in this subpart notwithstanding, a swap dealer or major swap participant that is a non-U.S. person or a foreign branch of a U.S. person shall not be subject to the requirements of this subpart with respect to any transaction in swaps (or any swap that is offered but not entered into) where its counterparty is a foreign branch of a U.S. person that is a swap dealer or major swap participant or is a non-U.S. person.

(b) Notwithstanding paragraph (a) of this section, a swap dealer that is a non-U.S. person or a foreign branch of a U.S. person shall be subject to the requirements set forth in §§ 23.410 and 23.433 if the swap dealer uses personnel located in the United States to arrange, negotiate, or execute a transaction in swaps or a swap that is offered but not entered into.

Issued in Washington, DC, on October 11, 2016, by the Commission.

Christopher J. 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 External Business Conduct Standards 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 Massad and Commissioners Bowen and Giancarlo voted in the affirmative. No Commissioner voted in the negative.

Appendix 2—Statement of Chairman Timothy G. Massad

I am pleased to support this proposal, which addresses several important aspects of the cross-border application of our swaps rules.

First, it seeks to enhance clarity and consistency in the application of our rules by proposing to define certain key terms, including the terms ''U.S. person'' and ''Foreign Consolidated Subsidiary'' (FCS), consistent with how they are defined in the Commission's cross-border margin rule.

Second, the proposal provides a clear standard for determining whether a swap dealing transaction should be included in an entity's calculation of whether it must register as a swap dealer. The proposal states that for U.S. persons, as well as those non-U.S. persons whose swaps are guaranteed by a U.S. person or that are a financially consolidated subsidiary of a U.S. ultimate parent (FCS), all swap dealing transactions must be included. All other persons would include swap dealing transactions with counterparties that are U.S. persons or FCSs, as well as swaps that have a U.S. guarantee, unless the swap is executed anonymously on a registered platform and cleared. The Proposed Rule provides a similar counting framework for the major swap participant registration threshold.

We are also proposing the application of external business conduct (EBC) standards for cross-border transactions, including those transactions that are arranged, negotiated, or executed by personnel in the U.S. Specifically, U.S. swap dealers would be required to comply with applicable standards, with the exception of their foreign branches. Non-U.S. swap dealers and foreign branches of U.S. swap dealers would be required to comply with applicable EBC standards for transactions with a U.S. counterparty—other than the foreign branch of a U.S. entity. For all other transactions, these dealers would not be subject to EBC standards, unless they use personnel located in the United States to arrange, negotiate, or execute such transactions. In that case, they would be required to comply with those EBC standards prohibiting fraud and other abusive conduct.

This aspect of our proposal follows up on a staff advisory and a Commission request for comment relating to non-U.S. swap dealers using personnel located in the United States to arrange, negotiate, or execute swap transactions. We will address whether other requirements should apply to such transactions at a later date.

This is just the latest in a number of steps we have taken to address cross-border issues in swaps rules. We have harmonized clearinghouse regulation through our accord with the European Commission—as well as through our work to address recovery and resolution internationally. We have given exemptions from registration to several foreign clearinghouses, and granted ''foreign board of trade'' status to several exchanges. We are actively working on harmonizing data reporting standards, and we are looking at whether we can do the same regarding trading requirements. And we harmonized requirements on margin for uncleared swaps, adopted a cross-border approach to that rule, and recently issued our first comparability determination for margin.

I wish to express my appreciation for the hard work of the CFTC staff in putting together these important rules. I thank Commissioner Bowen and Giancarlo for their support. And I encourage market participants to give us their comments on this proposed rule.

Appendix 3—Concurring Statement of Commissioner Sharon Y. Bowen

The rule proposal we have before us is significant. It addresses a number of important issues including: (i) The ''US Person'' definition; (ii) the treatment of foreign affiliates of US Persons (''Foreign Consolidated Subsidiaries'' or ''FCS''); (iii) the application of the de minimis threshold and business conduct standards to non-US registered dealers; and (iv) the treatment of swap trades that are ''arranged, negotiated, or executed'' in the US by foreign-based dealers but booked elsewhere.

I intend to vote ''yes'' for this proposed rule. Although I do not agree with every part of the proposal, I believe the proposal and questions lay out the key issues to allow for meaningful comments from the public. In that vein, I strongly urge market participants and members of the general public to comment on this rule proposal before the Commission makes a final decision. Its importance to our overall effort to regulate the swaps market requires us to take special care in considering how average investors and interested citizens feel about this proposal before we decide to finalize it.

I like many aspects of this rule. First, I am happy to see that it largely adopts the US Person and FCS definitions from the cross border margin rule. Whenever possible, we should try to make our rules consistent with each other; so this is a move in the right direction.

Second, it proposes that three important groups: US-based dealers, non-US entities guaranteed by US persons, and FCS—each count *all* of their swaps—those with US persons and non-US persons—towards the de minimis threshold. It is important that we subject non-US entities guaranteed by US persons, and FCS to this standard, because their swap risks have a material effect on the related US entity, and therefore, poses risks to our US financial system. Thus, it makes sense that we count all of their dealing activity in determining whether they engage in enough dealing to require registration.

However, I especially invite robust comment on certain aspects of the proposal:

Conduit Affiliates: I am concerned that the current proposal does not capture the dealing activity of ''conduit affiliates.'' A conduit affiliate is (i) a non-US affiliate that is consolidated with a US entity (or where a non-US affiliate and a US entity are consolidated) where there is no ultimate US parent and (ii) which transfers, through back to back swaps, the risk of swaps it enters into with non-US counterparties to that US person. They, in essence, serve as conduits for US entities to engage in, and ultimately assume the risk of, non-US swap activity. One would assume that these conduit affiliates would be captured by our rules and therefore would have to count this activity towards the de minimis threshold. However, this is not the case. That US entity could engage in billions of dollars of swap activity through its conduit affiliate and avoid all of our swap requirements.[1] This is a market risk concern. This issue is clearly highlighted in the questions, and I would be very interested in hearing comments about whether we should close this loophole, and require that conduit affiliates count all their trades, in which the risk is transferred to a US dealer, towards the de minimis threshold.

Arranged, Negotiated, or Executed: While I am believe it is good that the proposal requires that all US trading desk personnel of non-US dealers are held to conduct standards, I am not certain that we have gone far enough. Specifically, I encourage comment on whether the dealing activity that occurs in the US with US personnel from the trading desk of a non-US dealer should be counted towards that non-US dealer's threshold, even though the transactions are between two non-US counterparties and are booked outside the US. The FCS definition rightly requires non-US consolidated subsidiaries with a US parent to count all of their swap dealing activity towards the threshold, regardless of where it is booked. Does it make sense then that non-US dealers can use their US desks to engage in billions of dollars of swap dealing and never have that counted because the swaps are booked elsewhere? Are we, unnecessarily, putting US dealers at a serious competitive disadvantage to other dealers who are doing the very same thing sometimes just a few offices away? [2] Moreover, our fellow regulator, the Securities and Exchange Commission has answered ''yes'' to that question: Under their rules, non-US dealers must count security-based swap transactions that are arranged, negotiated or executed by US personnel toward their de minimis

[1] Also, if we find the jurisdiction where the transaction occurs comparable, none of these swaps would have to be margined either.

[2] ''Remarks of Chairman Gary Gensler at Swap Execution Facility Conference: Bringing Transparency and Access to Markets'' (Nov. 18, 2013), available at *http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-152* (''[A] U.S. swap dealer on the 32nd floor of a New York building and a foreign-based swap dealer on the 31st floor of the same building, have to follow the same rules when arranging, negotiating or executing a swap. One elevator bank . . . one set of rules.'').

threshold.[3] Thus, if we choose not to do so, we would not be harmonized with our fellow regulator, which governs an important part of the swaps markets.

For these reasons, and others, I would strongly encourage the public and market participants, particularly our US dealers, to comment on this proposal. Thank you.

Appendix 4—Statement of Commissioner J. Christopher Giancarlo

I support issuing today's proposed rule in order to hear commenters' considered views, especially with respect to the Commission's approach on the issue of U.S. personnel arranging, negotiating or executing transactions for two non-U.S. persons.

I have been a critic of the Commission's 2013 over-expansive cross-border interpretative guidance [4] and its avoidance of the rulemaking process to implement the sweeping policies contained therein. I consider both of these failings as having been compounded by the Division of Swap Dealer and Intermediary Oversight (DSIO) Advisory No. 13–69 [5] stating that CFTC transaction-level requirements apply to swaps between a non-U.S. swap dealer and a non-U.S. person if the swap is arranged, negotiated or executed by personnel or agents of the non-U.S. swap dealer located in the U.S. (ANE Transactions). Today the Commission is proposing a rulemaking on the cross-border application of the registration thresholds and external business conduct standards to swap dealers and major swap participants and the ANE Transactions in DSIO Advisory No. 13–69. I commend the Commission for at last putting the guidance and advisory through the formal rulemaking process.

The proposed rule provides that these ANE Transactions fall within the scope of the Dodd-Frank Act and that it may be appropriate to apply specific swap requirements to such transactions to advance Dodd-Frank's regulatory objectives. Yet, it also preliminarily determines that applying registration thresholds and external business conduct standards to such ANE Transactions would not further Dodd-Frank's regulatory objectives, except for certain abusive practices and fair dealing rules with respect to external business conduct standards. While this limited application seems appropriate, I am interested to hear commenters' thoughts about the Commission's approach and rationale before reaching a decision.

Since this proposal only addresses registration thresholds and external business conduct standards, the Commission says it intends to address the application of other Dodd-Frank swap requirements to ANE Transactions in subsequent rulemakings as necessary and appropriate. Until that happens, I urge the staff to commit to extend no-action letter 16–64 [6] in order to provide clarity that those swap requirements do not apply to ANE Transactions. This will provide the marketplace with certainty that all the swap requirements not addressed in today's rulemaking will not apply to ANE Transactions until the Commission takes further action.

[FR Doc. 2016–24905 Filed 10–17–16; 8:45 am]

BILLING CODE 6351–01–P

[3] 17 CFR 240.3a71–3(b)(1)(iii)(C). *See also* ''Security-Based Swap Transactions Connected With a Non-U.S. Person's Dealing Activity That Are Arranged, Negotiated, or Executed by Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent; Security-Based Swap Dealer De Minimis Exception; Final Rule,'' 81 FR 8598 (Feb. 19, 2016).

[4] Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 FR 45292 (Jul. 26, 2013), *http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2013-17958a.pdf.*

[5] CFTC Staff Advisory No. 13–69 (Nov. 14, 2013), *http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/13-69.pdf.*

[6] CFTC Letter No. 16–64 (Aug. 4, 2016), *http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/16-64.pdf.*