

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Parts 201 and 240

[Release No. 34–87780; File No. S7–07–19]

RIN 3235–AM13

### Cross-Border Application of Certain Security-Based Swap Requirements

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rules; guidance.

**SUMMARY:** The Securities and Exchange Commission (“SEC” or “Commission”) is adopting rule amendments and providing guidance to address the cross-border application of certain security-based swap requirements under the Securities Exchange Act of 1934 (“Exchange Act”) that were added by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). The Commission also is issuing a statement regarding compliance with rules for security-based swap data repositories and Regulation SBSR.

#### DATES:

*Effective date:* These rules are effective April 6, 2020.

*Compliance date:* The compliance dates are discussed in Part X.B of this final release.

#### FOR FURTHER INFORMATION CONTACT:

Carol M. McGee, Assistant Director, Laura Compton, Senior Special Counsel, or Kateryna Imus, Special Counsel, regarding the guidance related to security-based swap transactions that have been “arranged” or “negotiated” by personnel located in the United States, the amendment to Exchange Act Rule 3a71–3, applications for substituted compliance, the amendments to Rule 0–13 related to designation as a listed jurisdiction, and the compliance dates and statement regarding compliance with rules for security-based swap data repositories and Regulation SBSR referenced in Part X, at 202–551–5870; Devin Ryan, Senior Special Counsel, and Edward Schellhorn, Special Counsel, regarding the amendment to Commission Rule of Practice 194; Joanne Rutkowski, Assistant Chief Counsel, and Bonnie Gauch, Senior Special Counsel, regarding the amendments to Exchange Act Rule 15Fb2–1 and guidance related to Exchange Act Rule 15Fb2–4; and Joseph Levinson, Senior Special Counsel, regarding the modifications to Exchange Act Rule 18a–5, at 202–551–5777; Division of Trading and Markets, Securities and Exchange Commission,

100 F Street NE, Washington, DC 20549–7010.

**SUPPLEMENTARY INFORMATION:** The Commission is providing guidance regarding the application of certain uses of the terms “arranged” and “negotiated” in connection with the cross-border application of security-based swap regulation under the Exchange Act; providing guidance regarding the certification and opinion of counsel requirements in Exchange Act Rule 15Fb2–4 and Rule 3a71–6 and adequate assurance requirement in Exchange Act Rule 3a71–6; adopting amendments to Exchange Act Rules 0–13, 3a71–3, 15Fb2–1, and 18a–5 and Commission Rule of Practice 194; and issuing a statement regarding compliance with rules for security-based swap data repositories and Regulation SBSR.

#### I. Overview

The Commission is enhancing the effectiveness and the efficiency, in the cross-border context, of rules that implement requirements under Title VII of the Dodd-Frank Act<sup>1</sup> to provide for the regulation of security-based swap activity. The amendments finalize proposals that the Commission made to address issues regarding the cross-border application of Title VII.<sup>2</sup> Previously, market participants and other commenters had raised concerns regarding possible disruptive effects associated with several requirements that implicate cross-border activity in the security-based swap market, suggesting that those requirements would create significant operational burdens and impose unwarranted costs. The Commission also noted that those concerns may be exacerbated by differences between the Commission’s rules in those areas and corresponding rules of the Commodity Futures Trading Commission (“CFTC”) in connection with the regulation of the swaps market.<sup>3</sup>

Commenters addressed a range of issues regarding the proposed rules and guidance, and those comments are addressed below.<sup>4</sup> The Commission has

carefully considered commenters’ views. For the reasons discussed below, the Commission is taking the following actions:

- The Commission is providing guidance regarding the terms “arrange” and “negotiate,” as those terms are used within certain rules connected to the cross-border application of Title VII.<sup>5</sup>
- The Commission is adopting a conditional exception to provisions of Exchange Act Rule 3a71–3 that otherwise would require non-U.S. persons to count—against the thresholds associated with the *de minimis* exception to the “security-based swap dealer” definition—security-based swap dealing transactions with non-U.S. counterparties when U.S. personnel arrange, negotiate, or execute those transactions.<sup>6</sup>

- The Commission is adopting an amendment to Exchange Act Rule 15Fb2–1 to allow a nonresident security-based swap dealer or major security-based swap participant (each, an “SBS Entity”) that is unable to provide the certification and opinion of counsel required by Rule 15Fb2–4, to be conditionally registered if the nonresident SBS Entity instead submits a certification and an opinion of counsel that identify, and are conditioned upon, the occurrence of a future action that would provide the Commission with adequate assurances of prompt access to the books and records of the nonresident SBS Entity, and the ability of the nonresident SBS Entity to submit to onsite inspection and examination by the Commission. A nonresident SBS Entity that submits a conditional certification and opinion of counsel in connection with an application that otherwise is complete in all respects shall be conditionally registered and

O’Malia, CEO, International Swaps and Derivatives Association, dated July 23, 2019 (“ISDA letter”) at 3–4 (arguing that the CFTC’s rules for swaps and the Commission’s rules regarding security-based swaps, including those not proposed to be amended, should not materially differ); Yolanda Lewis, dated July 23, 2019 (generally discussing certain issues related to certificate-less bonds and employees’ securities companies).

<sup>5</sup> As discussed in more detail below, these rules include provisions of Exchange Act Rule 3a71–3 regarding the cross-border application of the “security-based swap dealer” definition, the cross-border application of security-based swap dealer business conduct requirements, and provisions related to activities of foreign branches of U.S. banks. These also include provisions of Regulation SBSR regarding the cross-border application of regulatory reporting and public dissemination requirements, and provisions of Rule 3a67–10 regarding the cross-border application of definitions and requirements applicable to major security-based swap participants. See generally Part II.B, *infra*.

<sup>6</sup> In connection with that exception, the Commission also is adopting a technical amendment to Exchange Act Rule 0–13.

<sup>1</sup> Public Law 111–203, 124 Stat. 1376 (2010). Unless otherwise indicated, references to Title VII in this release are to Subtitle B of Title VII of the Dodd-Frank Act.

<sup>2</sup> Proposed Rule Amendments and Guidance Addressing Cross-Border Application of Certain Security-Based Swap Requirements, Exchange Act Release No. 85823 (May 10, 2019), 84 FR 24206 (May 24, 2019) (“Proposing Release”).

<sup>3</sup> See Proposing Release, 84 FR at 24207.

<sup>4</sup> The comment letters are available at <https://www.sec.gov/comments/s7-07-19/s70719.htm>. The Commission also received comments on topics outside the scope of the proposal that are not addressed in this release. See letter from Scott

will remain conditionally registered until the Commission acts to grant or deny ongoing registration. If none of the future actions that are included in an applicant's conditional certification and opinion of counsel occurs within 24 months of the compliance date for Rule 15Fb2-1, and there is not otherwise a basis that would provide the Commission with the required assurances, the Commission may institute proceedings thereafter to determine whether ongoing registration should be denied.

- The Commission is providing guidance regarding the requirements, in Exchange Act Rules 15Fb2-4(c) and 3a71-6, to provide the Commission with a certification and opinion of counsel, including with respect to the foreign laws to be covered in the certification and opinion of counsel of a nonresident SBS Entity; the scope of the books and records covered by the certification and opinion of counsel; whether the certification and opinion of counsel can be predicated on consents (if consents are allowed in the relevant jurisdiction); and whether the certification and opinion of counsel can rely on a memorandum of understanding ("MOU"), agreement, protocol, or other regulatory arrangement with the Commission facilitating access to the books and records of SBS Entities located in that jurisdiction, an applicant's understanding of the general experience with the application of the relevant local law or rule, or a Commission order granting substituted compliance based on a finding of "adequate assurances" in accordance with Exchange Act Rule 3a71-6(c).

- The Commission is adopting, as proposed, an amendment to Rule of Practice 194, by including proposed paragraph (c)(2), to exclude an SBS Entity, subject to certain limitations, from the prohibition in Exchange Act Section 15F(b)(6) with respect to an associated person who is a natural person who (i) is not a U.S. person and (ii) does not effect and is not involved in effecting security-based swap transactions with or for counterparties that are U.S. persons, other than a security-based swap transaction conducted through a foreign branch of a counterparty that is a U.S. person.

- The Commission is adopting, as proposed, amendments to Rule 18a-5 to

provide that a bank<sup>7</sup> or stand-alone<sup>8</sup> SBS Entity is not required to make and keep current a questionnaire or application for employment executed by an associated person if the SBS Entity is excluded from the prohibition in Section 15F(b)(6) of the Exchange Act with respect to such associated person. The Commission also is adopting amendments to Rule 18a-5 to provide that a questionnaire or application for employment executed by an associated person who is not a U.S. person need not include all of the information described in paragraphs (a)(10)(i)(A) through (H) and (b)(8)(i)(A) through (H) of Rule 18a-5 unless the SBS Entity (1) is required to obtain such information under applicable law in the jurisdiction in which the associated person is employed or located or (2) obtains such information in conducting a background check that is customary for such firms in that jurisdiction, and the creation or maintenance of records reflecting that information would not result in a violation of applicable law in the jurisdiction in which the associated person is employed or located.<sup>9</sup>

- The Commission is issuing a statement regarding compliance with rules for security-based swap data repositories and Regulation SBSR.

A number of these final actions have been modified from the proposals to address issues raised by commenters, and more generally to enhance the actions' effectiveness and efficiency. The Commission has consulted and coordinated with staff of the CFTC and the prudential regulators,<sup>10</sup> in

<sup>7</sup> The Exchange Act distinguishes between SBS Entities for which there is a prudential regulator as defined in Section 1a(39) of the Commodity Exchange Act ("CEA"), 7 U.S.C. 1a(39), incorporated by reference in Section 3(a)(74) of the Exchange Act, 15 U.S.C. 78c(a)(74), and those that are not subject to supervision by a prudential regulator (*see, e.g.*, 15 U.S.C. 78o-10(f)(1)(B)). SBS Entities for which there is a prudential regulator are referred to herein as "bank SBS Entities."

<sup>8</sup> An SBS Entity for which there is no prudential regulator could be dually registered with the Commission as a broker-dealer ("broker-dealer SBS Entity") or registered with the Commission only as an SBS Entity ("stand-alone SBS Entity").

<sup>9</sup> 17 CFR 240.17a-3(a)(12) requires broker-dealers, including broker-dealer SBS Entities, to make and keep current a questionnaire or application for employment for each associated person that contains information about the associated person (the "questionnaire requirement") as well other information about associated persons. The Commission adopted parallel requirements in Rule 18a-5 for stand-alone and bank SBS Entities. *See* Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers; Capital Rule for Certain Security-Based Swap Dealers, Exchange Act Release No. 87005 (Sep. 19, 2019), 84 FR 68550 (Dec. 16, 2019) ("Recordkeeping and Reporting Adopting Release").

<sup>10</sup> The term "prudential regulator" is defined in Section 1a(39) of the CEA, 7 U.S.C. 1a(39), and that definition is incorporated by reference in Section

accordance with the consultation mandate of the Dodd-Frank Act.<sup>11</sup> The Commission also has consulted and coordinated with foreign regulatory authorities through Commission staff participation in numerous bilateral and multilateral discussions with foreign regulatory authorities addressing the regulation of OTC (over-the-counter) derivatives.<sup>12</sup>

## II. Security-Based Swap Transactions Arranged, Negotiated, or Executed by U.S. Personnel

### A. Use of "Arranged, Negotiated, or Executed" Criteria

#### 1. Background

A number of the rules implementing Title VII in the cross-border context account for whether security-based swap transactions have been arranged, negotiated, or executed by personnel located in the United States. In 2016, the Commission adopted Exchange Act Rule 3a71-3(b)(1)(C)(iii). The rule provides that for purposes of determining whether non-U.S. persons will be deemed to be security-based swap dealers—and hence subject to the Title VII requirements applicable to

3(a)(74) of the Exchange Act, 15 U.S.C. 78c(a)(74). Pursuant to the definition, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration, or the Federal Housing Finance Agency (collectively, the "prudential regulators") is the "prudential regulator" of a security-based swap dealer or major security-based swap participant if the entity is directly supervised by that regulator.

<sup>11</sup> Section 712(a)(2) of the Dodd-Frank Act provides in part that the Commission shall "consult and coordinate to the extent possible with the Commodity Futures Trading Commission and the prudential regulators for the purposes of assuring regulatory consistency and comparability, to the extent possible."

In addition, Section 752(a) of the Dodd-Frank Act provides in part that "[i]n order to promote effective and consistent global regulation of swaps and security-based swaps, the Commodity Futures Trading Commission, the Securities and Exchange Commission, and the prudential regulators . . . as appropriate, shall consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation (including fees) of swaps."

<sup>12</sup> Staff participates in a number of international standard-setting bodies and workstreams working on OTC derivatives reforms. For example, Commission staff participates in the Financial Stability Board's Working Group on OTC Derivatives Regulation. Commission staff also participates in the International Organization of Securities Commissions ("IOSCO") Committee on Derivatives, the joint Basel Committee on Banking Supervision ("BCBS") and IOSCO Working Group on Margin Requirements' Monitoring Group and participates in international working groups that impact OTC derivatives financial market infrastructures, such as Committee on Payment Market Infrastructures ("CPMI")—IOSCO joint working groups assessing legal and regulatory frameworks for central counterparties and trade repositories and examining central counterparty resilience and recovery.

security-based swap dealers—non-U.S. persons (other than conduit affiliates as defined in the rule) must count, against the applicable *de minimis* threshold, their security-based swap dealing transactions with non-U.S. counterparties that were “arranged, negotiated, or executed” by personnel within the United States.<sup>13</sup> The Commission also incorporated the “arranged, negotiated, or executed” criteria into the cross-border application of other parts of the security-based swap dealer *de minimis* counting rules,<sup>14</sup> of the cross-border application of business conduct provisions for SBS Entities,<sup>15</sup> of Regulation SBSR’s regulatory reporting and public dissemination provisions,<sup>16</sup> and of Title VII rules regarding major security-based swap participants.<sup>17</sup>

In the Proposing Release, the Commission solicited comment regarding how U.S. personnel are used in connection with cross-border security-based swap transactions, and regarding the impacts of tests that account for the activity of U.S. personnel.<sup>18</sup> The Commission also solicited comment on guidance regarding the use of the terms

“arranged” and “negotiated” in the cross-border application of Title VII rules, as well as on two alternative approaches to a conditional exception to Rule 3a71–3(b)(1)(C)(iii).<sup>19</sup> The proposals sought to address concerns that had been raised regarding the consequences associated with the incorporation of “arranged, negotiated, or executed” criteria in the cross-border application of Title VII, in a manner that balanced two competing considerations.<sup>20</sup> On one hand, the proposals reflected the Commission’s continued belief that the use of “arranged, negotiated, or executed” criteria appropriately should constitute part of the security-based swap dealer *de minimis* counting requirement in connection with transactions involving two non-U.S. counterparties, in part due to the risk that non-U.S. persons engaged in security-based swap dealing activity in the United States otherwise could avoid regulation under Title VII.<sup>21</sup> On the other hand, the proposals also reflected the Commission’s recognition that the use of “arranged, negotiated, or executed” criteria as part of the *de minimis* counting requirement might produce negative consequences such as causing financial groups “to relocate U.S. personnel or relocate the activities performed by U.S. personnel, to avoid security-based swap dealer registration,” and that those results “have the potential to increase fragmentation and harm U.S. market participants and the U.S. economy.”<sup>22</sup>

## 2. Commission Action

After considering comments submitted in response to the Proposing Release, the Commission continues to believe the “arranged, negotiated, or executed” criteria form an appropriate basis for applying Title VII requirements in the cross-border context.<sup>23</sup> At the

same time, after considering commenters’ views, the Commission continues to recognize that the use of “arranged, negotiated, or executed” criteria has the potential to lead to a variety of negative consequences. Accordingly, the Commission is issuing guidance regarding the application of the terms “arranged” and “negotiated” in the cross-border application of Title VII rules to the provision of “market color,” as well as adopting a conditional exception from the incorporation of “arranged, negotiated, or executed” criteria as part of the *de minimis* counting test.<sup>24</sup>

As the Commission previously recognized, the “arranged, negotiated, or executed” criteria serve important regulatory interests, including helping protect against the potential that market participants would use booking practices to engage in an unregistered security-based swap dealing business in the United States. Those criteria further

bases for continuing to apply Dodd-Frank Act requirements to ANE Transactions based on a territorial analysis of the SEC’s cross-border jurisdiction”); letter from Americans for Financial Reform Education Fund, dated July 23, 2019 (“AFR letter”) at 2 (“we also pointed out that given the narrow definition of U.S. person under the rule, the inclusion of ANE transactions in the *de minimis* count was an absolutely crucial protection to include in the rule”).

In contrast, some commenters reiterated opposition to any use of “arranged, negotiated, or executed” criteria in connection with Title VII implementation, including cross-border tests related not only to the *de minimis* exception to the “security-based swap dealer” definition, but also to other requirements related to security-based swap dealer registration, to business conduct requirements and to reporting and public dissemination requirements. See letter from Briget Polichene, CEO, Institute of International Bankers, and Kenneth E. Bentsen, President and CEO, Securities Industry and Financial Markets Association, dated July 23, 2019 (“IIB/SIFMA letter”) at 7–8, 16–18; ISDA letter at 4–7; letter from Wim Mijs, CEO, European Banking Federation, dated July 23, 2019 (“EBF letter”) at 7; letter from Mark Hutchinson, Managing Director & General Counsel, HSBC Bank USA, N.A., dated July 23, 2019 (“HSBC letter”) at 2–3. Some of these commenters also expressed the view, however, that the proposed exception would partially—but not completely—address the problems they identified in connection with the use of those criteria. See IIB/SIFMA letter at 2 (stating that if the Commission does not adopt the commenter’s recommended approach of not incorporating “arranged, negotiated, or executed” criteria as part of Title VII implementation, it should “adopt a modified version of the Proposal’s conditional exception from the *de minimis* calculation”); ISDA letter at 7–9; HSBC letter at 1, 5. One commenter also argued that the Commission should exempt all non-U.S. registered security-based swap dealers from business conduct requirements other than those that also apply to transactions subject to the proposed exception to the *de minimis* counting requirement. See IIB/SIFMA letter at 16.

<sup>24</sup> As noted in the Proposing Release, the antifraud provisions of the federal securities laws and certain relevant Title VII requirements would continue to apply to the transactions subject to the exception. See Proposing Release, 84 FR at 24219.

<sup>13</sup> See Proposing Release, 84 FR at 24208 nn.12–13.

Rule 3a71–3 further requires that such non-U.S. persons count their dealing transactions with certain U.S. counterparties, their dealing transactions in which their performance under the security-based swap is guaranteed by a U.S. affiliate, and, in some circumstances, certain transactions of affiliates. See Exchange Act Rules 3a71–3(b)(1)(iii)(A)–(B), (b)(2) and 3a71–4, 17 CFR 240.3a71–3(b)(1)(iii)(A)–(B), (b)(2) and 3a71–4.

Persons whose dealing activities exceed the *de minimis* thresholds will be required to register as security-based swap dealers. See Exchange Act Section 3(a)(71)(D), 15 U.S.C. 78(c)(a)(71)(D); Exchange Act Rule 3a71–2, 17 CFR 240.3a71–2. For a discussion of the compliance date for registration of security-based swap dealers, see Part X.B.

<sup>14</sup> See Proposing Release, 84 FR at 24208 n.81.

<sup>15</sup> See Exchange Act Rule 3a71–3(c), 17 CFR 240.3a71–3(c). See Proposing Release, 84 FR at 24208 n.79 for further discussion.

<sup>16</sup> See Regulation SBSR Rules 908(a)(1)(v) and 908(b)(5), 17 CFR 242.908(a)(1)(v) and 908(b)(5) (incorporating an “arranged, negotiated, or executed” standard). See Proposing Release, 84 FR at 24208 n.80 for further discussion.

<sup>17</sup> See Exchange Act Rule 3a67–10(b)(3)(i), 17 CFR 240.3a67–10(b)(3)(i) (setting out that the “major security-based swap participant” excludes positions that arise from transactions conducted through a foreign branch of a counterparty that is a registered security-based swap dealer and thus incorporating the definition of “transaction conducted through a foreign branch,” which makes use of “arranged, negotiated, and executed” criteria); Exchange Act Rule 3a67–10(d), 17 CFR 240.3a67–10(d) (stating that U.S. and non-U.S. major security-based swap participants are excluded from having to comply with certain business conduct requirements in connection with transactions conducted through a foreign branch, based on that same definition). See Proposing Release, 84 FR at 24208 n.82 for further discussion.

<sup>18</sup> See Proposing Release, 84 FR at 24217, 24227–28.

<sup>19</sup> See Proposing Release, 84 FR at 24217–18, 24237–43.

<sup>20</sup> See Proposing Release, 84 FR at 24207–08.

<sup>21</sup> See Proposing Release, 84 FR at 24208–09, 24218.

<sup>22</sup> See *id.* at 24216, 24218.

<sup>23</sup> Some commenters supported these criteria, with one noting that failure to regulate these transactions under Title VII would create competitive disparities between U.S. and non-U.S. market participants, while regulating these transactions “will enable the Commission to better monitor for disruptive trading practices and will also provide the necessary data regarding overall market trading activity to allow the Commission to evaluate market trends and accurately assess the impact of other reforms implemented in the security-based swap market.” See letter from Stephen Berger, Managing Director, Citadel, dated July 23, 2019 (“Citadel letter”) at 2–5; see also letter from Dennis Kelleher, President and CEO, Better Markets, dated July 23, 2019 (“Better Markets letter”) at 11 (“Better Markets would like to commend the SEC for affirming fundamental legal

reflect the activity-based focus of the “security-based swap dealer” definition,<sup>25</sup> as well as considerations regarding competitive disparities, market fragmentation, and public transparency. Similarly, the Title VII SBS Entity requirements more generally serve a number of regulatory purposes apart from mitigating counterparty and operational risks, “including enhancing counterparty protections and market integrity, increasing transparency, and mitigating risk to participants in the financial markets and the U.S. financial system more broadly.”<sup>26</sup>

For similar reasons, the Commission is unpersuaded by one commenter’s suggestion<sup>27</sup> to replace the “arranged,

negotiated, or executed” criteria for applying Title VII in the cross-border context with a “primary trading relationship” test. Moreover, the Commission recognizes that a test, such as a primary trading relationship test, that purports to distinguish between “direct” and “meaningful” involvement in a transaction on the one hand, and “occasional” and “incidental” involvement on the other hand, in practice would be subject to subjective and inconsistent application.

At the same time, commenters argued that the use of “arranged, negotiated, or executed” criteria has the potential to lead to a variety of negative consequences. In particular, commenters expressed concern that these criteria may cause the relocation of operations and personnel out of the United States, inhibit the use of centralized risk management, reduce liquidity in the U.S. market, increase fragmentation in global markets, impose significant compliance costs and logistical challenges, and produce competitive disparities.<sup>28</sup> As discussed below, the conditional exception should help mitigate the negative consequences that otherwise may arise from the use of those criteria to their security-based swap business, while also helping to avoid allowing persons to engage in an unregulated security-based swap dealing business in the United States.

Commenters expressed concerns about both the proposed “market color” guidance and the proposed conditional exception. Some commenters asserted that the proposed guidance would encourage market participants to restructure their security-based swaps business to avoid the requirements of the Dodd-Frank Act.<sup>29</sup> Commenters argued that this evasion would impede the Commission’s ability to monitor compliance,<sup>30</sup> as well as to exercise its anti-fraud authority.<sup>31</sup> Commenters also worried that the Commission would lose the ability to oversee the vast majority of “arranging” and “negotiating” activity.<sup>32</sup> Similarly, some commenters objected to the proposed

exception to the *de minimis* counting rule, asserting that the proposal reflected industry preference contrary to the Commission’s public interest mandate,<sup>33</sup> was unsupported by new information,<sup>34</sup> and would permit certain market participants to use booking practices to avoid having to register as security-based swap dealers.<sup>35</sup> The Commission recognizes that the guidance addresses certain activity that will not be cross-border “arranging” and “negotiating” subject to the application of certain Title VII rules. Further, the Commission is mindful that the exception modifies the approach taken in 2016, when the Commission incorporated the “arranged, negotiated, or executed” criteria into the *de minimis* counting rule. Though the exception does permit market participants to avoid counting certain “arranging, negotiating, or executing” activity towards the security-based swap dealer registration thresholds, in the Commission’s view, its approach appropriately balances the recent concerns presented by commenters<sup>36</sup> and helps avoid the potential negative consequences that some have suggested may be associated with the current “arranging, negotiating, or executing” standard. In the Commission’s view, this approach is in the public interest because it should help facilitate implementation of the Title VII security-based swap dealer requirements in a manner that is both effective and efficient.<sup>37</sup>

<sup>25</sup> See Better Markets letter at 1–2.

<sup>26</sup> See Better Markets letter at 25; AFR letter at 3–4.

<sup>27</sup> See AFR letter at 4; see also Citadel letter at 5 (expressing concerns regarding permitting counterparties to “engage in dealing activity using U.S.-based personnel without being appropriately registered with the Commission” in connection with expressing opposition to Alternative 2); letter from Karl Muth, dated July 19, 2019 (“Muth letter”) (expressing view that “the risk that non-U.S. persons engaged in security-based swap dealing activity in the United States could avoid regulation under Title VII . . . is a more serious risk than the risk that the ambit of Title VII may be expanded nominally in some unanticipated way”).

<sup>28</sup> See note 23, *supra*, and Parts I.B and I.C, *infra*.

<sup>29</sup> Three commenters expressed concerns regarding documentation-related compliance burdens in connection with the use of the “arranging, negotiating, or executing” standard in Title VII rules. See IIB/SIFMA letter at 16 (asserting that many business conduct requirements “would impose documentation burdens on non-U.S. counterparties that would deter them from having the interactions with U.S. personnel that would trigger these requirements”; suggesting an exemption from all business conduct requirements as applied to non-U.S. security-based swap dealers’ “arranging, negotiating, or executing” activity,” except for those requirements that are conditions to the new exception from the *de minimis* counting rule); ISDA letter at 7 (asserting that “certain

<sup>25</sup> As the Commission has previously noted, “Exchange Act Section 3(a)(71)(A) identifies specific activities that bring a person within the definition of a ‘security-based swap dealer’: (1) [h]olding oneself out as a dealer in security-based swaps; (2) making a market in security-based swaps; (3) regularly entering into security-based 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 in security-based swaps.” 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, Exchange Act Release No. 77104 (Feb. 10, 2016), 81 FR 8598, 8614 (Feb. 19, 2016) (“ANE Adopting Release”) (citing Exchange Act Section 3(a)(71)(A), 15 U.S.C. 78c(a)(71)(A)).

The Commission has interpreted this definition to apply to persons engaged in indicia of dealing activity. See ANE Adopting Release, 81 FR at 8614 (citing Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant,” Exchange Act Release No. 66868 (Apr. 27, 2012), 77 FR 30596, 30617–18 (May 23, 2012) (“Intermediary Definitions Adopting Release”).

Consistent with the statutory definition, the Commission has stated that the *de minimis* threshold relates to the volume of dealing activity and not to specific risk-related factors. Moreover, the fact that risk from a transaction between two non-U.S. persons exists largely outside the United States does not determine whether a sufficient nexus exists to require a non-U.S. person to count the transaction toward its *de minimis* threshold. Rather, “the appropriate analysis . . . also considers whether a non-U.S. person in such a transaction is engaged, in the United States, in any of the activities set forth in the statutory definition [or in the Commission’s further definition] of ‘security-based swap dealer.’” ANE Adopting Release, 81 FR at 8614.

<sup>26</sup> See Proposing Release, 84 FR at 24201 n.20. The Commission’s actions to mitigate the negative consequences potentially associated with the various uses of this type of test accordingly are designed to do so while preserving the important Title VII interests that the Commission advanced when it incorporated the test into the various cross-border rules. See Proposing Release, 84 FR at 24208.

<sup>27</sup> See HSBC letter (highlighting operational issues associated with the use of an “arranged, negotiated, or executed test” and stating that it would be more practical to make use of a “primary trading relationship” test that looks at “the nature of the trading relationship between the non-U.S.

parties and the U.S. personnel involved in the trade”; adding that that test would apply “if U.S. personnel are directly and meaningfully involved in the trading relationship with the non-U.S. parties at the relationship level (e.g., the client’s primary point of contact for the SBS is located in the United States), but not when “U.S. personnel are only occasionally and incidentally involved in the trading relationship with the non-U.S. parties”).

<sup>28</sup> See IIB/SIFMA letter at 7–8, 16–18; ISDA letter at 4–7; EBF letter at 7; HSBC letter at 2–3.

<sup>29</sup> See Citadel letter at 5; see also Better Markets letter at 17.

<sup>30</sup> See Citadel letter at 5.

<sup>31</sup> See Better Markets letter at 21.

<sup>32</sup> See Citadel letter at 5.

*B. Guidance Regarding the Meaning of “Arranged” and “Negotiated” in Connection With the Cross-Border Application of Title VII*

1. Proposed Approach

For purposes of the “arranged, negotiated, or executed” test, the Commission intended for the terms “arrange” and “negotiate” to “indicate market-facing activity of sales or trading personnel in connection with a

business conduct requirements would impose documentation burdens on non-U.S. counterparties that may incentivize them not to transact with nonresident [security-based swap dealers] that utilize U.S. personnel”; suggesting either an exemption from, or substituted compliance for, all business conduct requirements as applied to non-U.S. security-based swap dealers’ “arranging, negotiating, or executing” activity<sup>37</sup>; HSBC letter at 3–4 (noting that it would be “immensely cumbersome to modify [OTC derivatives regulation compliance systems] to systematically monitor and track the location of any front office personnel acting for HSBC”). Another commenter did not cite documentation burdens but called for an exemption from all business conduct requirements for transactions between two non-U.S. persons that are “arranged, negotiated, or executed” by U.S. personnel. See EBF letter at 7. For the reasons discussed above, the Commission continues to believe the “arranged, negotiated, or executed” criteria form an appropriate basis for applying Title VII requirements, including business conduct requirements, in the cross-border context. The Commission encourages potential foreign SBS Entity registrants, however, to contact the staff to discuss concerns regarding any disruption that may be associated with any documentation requirements arising from transactions that are arranged, negotiated, or executed by U.S. personnel. In this regard, the Commission notes that certain of these business conduct requirements are required by statute.

Similarly, three commenters expressed concerns regarding the application of Regulation SBSR to transactions between non-U.S. persons that are “arranged, negotiated, or executed” by U.S. personnel. See IIB/SIFMA letter at 16–18 (suggesting an exemption from Regulation SBSR for such transactions when they are reported in another jurisdiction but not publicly disseminated due to insufficient liquidity in that jurisdiction); ISDA letter at 5–7 (suggesting an exemption from Regulation SBSR for such transactions until the Commission issues substituted compliance determinations for all G–20 jurisdictions); EBF letter at 7 (suggesting an exemption from Regulation SBSR for such transactions). One commenter urged the Commission to continue applying Regulation SBSR to transactions between non-U.S. persons that are “arranged, negotiated, or executed” by U.S. personnel, to promote the Commission’s supervisory interest in monitoring U.S. trading activity and to increase transparency and enhance price discovery for U.S. market participants. See Citadel letter at 1, 2–5. For the reasons discussed above, the Commission continues to believe the “arranged, negotiated, or executed” criteria form an appropriate basis for applying Title VII requirements, including Regulation SBSR, in the cross-border context. Another commenter asked the Commission to allow transaction reports made pursuant to Regulation SBSR to mask counterparty information when a foreign legal barrier requires counterparty consent and/or regulatory authorization to report unmasked data. See IIB/SIFMA letter at 28–29. As discussed in Part X.C, the Commission is issuing a statement regarding compliance with Regulation SBSR. This statement takes account of these comments.

particular transaction, including interactions with counterparties or their agents.”<sup>38</sup> Recognizing that market-facing activity may vary significantly in connection with security-based swap transactions, the Commission proposed guidance regarding activity that is not “arranging” or “negotiating” for purposes of Title VII requirements.<sup>39</sup> The proposed guidance would have applied to the “arranged, negotiated, or executed” test that is used in connection with the *de minimis* counting rules<sup>40</sup> and in the cross-border application of business conduct rules,<sup>41</sup> regulatory reporting and public dissemination requirements,<sup>42</sup> and major security-based swap participant rules.<sup>43</sup>

In the Proposing Release, the Commission explained that in certain circumstances the market-facing activity of U.S. personnel is so limited that it would not implicate the regulatory interests underlying the relevant Title VII requirements.<sup>44</sup> The Commission proposed that such circumstances arise when U.S. personnel provide “market color” in connection with security-based swap transactions, but otherwise have no client responsibility and receive no transaction-linked compensation.<sup>45</sup>

<sup>38</sup> See ANE Adopting Release, 81 FR at 8622; see also Proposing Release, 84 FR at 24215.

<sup>39</sup> See Proposing Release, 84 FR at 24216.

<sup>40</sup> In connection with *de minimis* counting, this guidance would apply to: (1) Exchange Act Rule 3a71–3(b)(1)(iii)(C), which requires the counting of security-based swap dealing transactions between non-U.S. counterparties that have been “arranged, negotiated, or executed” in the United States, 17 CFR 240.3a71–3(b)(1)(iii)(C); (2) Exchange Act Rule 3a71–3(b)(2), which addresses the counting of affiliate transactions described by paragraph (b)(1) (which includes the (b)(1)(iii)(C) requirement), 17 CFR 240.3a71–3(b)(2); (3) Exchange Act Rule 3a71–5, which excepts certain cleared anonymous transactions from the individual counting requirement of paragraph (b)(1) of Rule 3a71–3 and from the affiliate counting requirement of paragraph (b)(2), but is unavailable to transactions “arranged, negotiated, or executed” by U.S. personnel, 17 CFR 240.3a71–5; and (4) the *de minimis* counting requirement of Exchange Act Rule 3a71–3(b)(1)(iii)(A), requiring the counting of dealing transactions involving a foreign branch of a registered security-based swap dealer and a non-U.S. counterparty (or another foreign branch), 17 CFR 240.3a71–3(b)(1)(iii)(A). The regulatory interests underlying the Rule 3a71–3(b)(1)(iii)(C) and Rule 3a71–3(b)(1)(iii)(A) uses of arranged, negotiated, and/or executed criteria to implement the *de minimis* counting requirement are similar (as are, derivatively, the Rule 3a71–3(b)(2) and Rule 3a71–5 uses).

The guidance also would apply to the definition of “transaction conducted through a foreign branch” in Rule 3a71–3(a)(3), which incorporates the functionally equivalent “arranged, negotiated, and executed” terminology.

<sup>41</sup> See note 14, *supra*.

<sup>42</sup> See note 16, *supra*.

<sup>43</sup> See note 17, *supra*.

<sup>44</sup> See Proposing Release, 84 FR at 24216.

<sup>45</sup> See *id.* at 24216–17.

The Commission further proposed that, for those purposes, the term “market color” would mean background information regarding pricing or market conditions associated with particular instruments or with markets more generally, including information regarding current or historic pricing, volatility, or market depth, and trends or predictions regarding pricing, volatility, or market depth, as well as other types of information reflecting market conditions and trends.<sup>46</sup> The Commission proposed that U.S. personnel who have no client responsibility and receive no transaction-linked compensation could provide market color in connection with security-based swap transactions in support of non-U.S. persons who actually arrange, negotiate, and execute those transactions on behalf of their clients, without triggering the requirements under Title VII that incorporate the “arranged, negotiated, or executed” test.<sup>47</sup> The Commission explained that, for purposes of the proposed guidance, having no client responsibility would mean that the U.S. personnel providing market color must not have been assigned, and must not otherwise exercise, client responsibility in connection with the transaction.<sup>48</sup> The Commission noted that the involvement of U.S. personnel who are designated as sales persons or traders would not necessarily trigger the “arranged, negotiated, or executed” test as long as such personnel’s activity is limited to the provision of market color, rather than arranging or negotiating.<sup>49</sup> The Commission also explained that U.S. personnel not receiving transaction-linked compensation means that the U.S. personnel do not receive compensation based on or otherwise linked to the completion of transactions on which the U.S. personnel provide market color.<sup>50</sup> The Commission clarified, however, that this does not include profit-sharing arrangements or other compensation practices that account for aggregated profits, as such arrangements would not be expected to incentivize U.S. personnel in a similar manner or to a similar degree as compensation that is directly linked to the success of individual transactions.<sup>51</sup> In proposing the guidance, the Commission reasoned that the provision of market color by U.S. personnel who have no client responsibility and receive

<sup>46</sup> See *id.* at 24216.

<sup>47</sup> See *id.* at 24217.

<sup>48</sup> See *id.* at 24217.

<sup>49</sup> See *id.* at 24216 n.95.

<sup>50</sup> See *id.* at 24217.

<sup>51</sup> See *id.* at 24217 n.96.

no transaction-linked compensation is a type of limited market-facing activity by U.S. personnel that, standing alone, would not trigger the concerns and regulatory interests that underpin the various uses of the “arranged, negotiated, or executed” test, as such activity would not appear comprehensive enough to pose a significant risk of allowing an entity to exit the Title VII regulatory regime without exiting the U.S. market.<sup>52</sup> Moreover, non-U.S. counterparties reasonably would not expect Title VII business conduct requirements to apply merely as the result of receiving technical information from U.S. personnel.<sup>53</sup> As noted in the Proposing Release, in circumstances where limited market-facing activity by U.S. personnel does not trigger the “arranged, negotiated, or executed” test, the federal securities laws, including applicable anti-fraud provisions, still may apply to that activity depending on the particular facts and circumstances.<sup>54</sup>

## 2. Commission Action

The Commission is providing the guidance largely as proposed, modified to further explain the term “market color.”<sup>55</sup> The Commission believes that, as revised, the guidance will help entities evaluate what is, and what is not, “market color.”

The Commission is providing guidance<sup>56</sup> regarding the “arranged, negotiated, or executed” test that is used in connection with *de minimis* counting,<sup>57</sup> the cross-border application

of business conduct rules,<sup>58</sup> regulatory reporting and public dissemination requirements,<sup>59</sup> and major security-based swap participant rules.<sup>60</sup>

In the Commission’s view, “market color” is limited to background information regarding pricing or market conditions associated with particular instruments or with markets more generally in support of persons who arrange, negotiate, or execute security-based swap transactions on behalf of their clients. Background information includes information regarding (1) current or historic pricing, volatility, or market depth, and (2) trends or predictions regarding pricing, volatility, or market depth, as well as information related to risk management.

The Commission is clarifying that U.S. personnel who provide market color in connection with security-based swap transactions—in the form of information or data as described above—do not trigger the Title VII requirements that use an “arranged, negotiated, or executed” test when both the following circumstances exist:

- *No client responsibility*—The U.S. personnel have not been assigned, and do not otherwise exercise, client responsibility in connection with the transaction.
- *No transaction-linked compensation*—The U.S. personnel do not receive compensation based on, or otherwise linked to, the completion of

5, which excepts certain cleared anonymous transactions from the individual counting requirement of paragraph (b)(1) of Rule 3a71–3 and from the affiliate counting requirement of paragraph (b)(2), but is unavailable to transactions “arranged, negotiated, or executed” by U.S. personnel, 17 CFR 240.3a71–5; and (4) the *de minimis* counting requirement of Exchange Act Rule 3a71–3(b)(1)(iii)(A), requiring the counting of dealing transactions involving a foreign branch of a registered security-based swap dealer and a non-U.S. counterparty (or another foreign branch), 17 CFR 240.3a71–3(b)(1)(iii)(A). The regulatory interests underlying the Rule 3a71–3(b)(1)(iii)(C) and Rule 3a71–3(b)(1)(iii)(A) uses of arranged, negotiated, and/or executed criteria to implement the *de minimis* counting requirement are similar (as are, derivatively, the Rule 3a71–3(b)(2) and Rule 3a71–5 uses).

The guidance also applies to the definition of “transaction conducted through a foreign branch” in Rule 3a71–3(a)(3), which incorporates the functionally equivalent “arranged, negotiated, and executed” terminology.

<sup>58</sup> See note 15, *supra* (addressing Exchange Act Rule 3a71–3(c), 17 CFR 240.3a71–3(c), business conduct exclusion).

<sup>59</sup> See note 16, *supra* (addressing Regulation SBSR Rules 908(a)(1)(v) and 908(b)(5), 17 CFR 242.908(a)(1)(v) and 908(b)(5), regarding the cross-border application of regulatory reporting and public dissemination requirements).

<sup>60</sup> See note 18, *supra* (addressing cross-border major security-based swap participant provisions of Exchange Act Rules 3a67–10(b)(3)(i) and 3a67–10(d), 17 CFR 240.3a67–10(b)(3)(i) and 3a67–10(d)).

individual transactions on which the U.S. personnel provide market color.<sup>61</sup>

In contrast, in the Commission’s view, any solicitation activity by personnel located in the United States or activity to respond to requests by counterparties to enter into transactions when such requests are made directly to personnel located in the United States would *not* be “market color.”<sup>62</sup> Moreover, market-facing activity by personnel located in the United States also would not be “market color” if such activity involves:

- Providing recommendations, such as recommending particular instruments;
- providing predictions regarding potential merits or risks of, or providing trading ideas or strategies relating to, a proposed security-based swap transaction;
- structuring a particular security-based swap transaction; or
- finalizing or reaching agreement with respect to any pricing or non-pricing element, such as underlier, notional amount or tenor, that must be resolved to complete a security-based swap transaction.

The language above is different from the language in the proposal in response to a number of commenters who expressed concern that it would be difficult to distinguish “market color” activity from “arranging” and “negotiating” activity.<sup>63</sup>

Commenters expressed concern that the guidance would encourage entities (including U.S. entities) to restructure to avoid or evade requirements applicable

<sup>61</sup> As stated in the Proposing Release, the Commission understands that it is commonplace for firms to account for the overall profit or loss of the firm, or of a particular division or office, in calculating compensation for personnel. Solely for the purposes of this guidance, the Commission does not view profit-sharing arrangements or other compensation practices that account for aggregated profits as transaction-linked compensation, as such arrangements would not be expected to incentivize U.S. personnel in a similar manner or to a similar degree as compensation that is directly linked to the success of individual transactions.

<sup>62</sup> See Intermediary Definitions Adopting Release, 77 FR at 30618 (identifying actively soliciting clients in security-based swaps as a factor in indicating that a person meets the statutory definition of security-based swap dealer); see also Application of “Security-Based Swap Dealer” and “Major Security-Based Swap Participant” Definitions to Cross-Border Security-Based Swap Activities, Exchange Act Release 34–72472 (Jun. 25, 2014), 79 FR 47278, 47322 n.364 (Aug. 12, 2014) (“Cross-Border Adopting Release”) (stating that the term “arranging” was used in lieu of “solicit” to reflect the fact that a person may engage in dealing activity not only through transactions that the person actively solicits, but also through transactions that result from counterparties reaching out to the person); ANE Adopting Release, 81 FR 8622 n.221.

<sup>63</sup> See Citadel letter at 5; Better Markets letter at 13–14.

<sup>52</sup> See *id.* at 24216 n.94.

<sup>53</sup> See *id.*

<sup>54</sup> See *id.* at 24217 n.97.

<sup>55</sup> Three commenters expressed general support for the guidance as proposed. See IIB/SIFMA letter at 3, 9–10; HSBC letter at 1, 5 (expressing general support for the comments in the IIB/SIFMA letter); ISDA letter at 2.

<sup>56</sup> The Commission continues to believe there is no reason to revisit its prior guidance regarding the scope of the term “execute”; the Commission therefore did not in the Proposing Release and does not now provide any additional guidance regarding the interpretation of that term. Moreover, although the Commission is providing guidance with respect to certain market-facing activities that in its view do not constitute arranging or negotiating for purposes of the relevant Title VII requirements, the Commission’s view otherwise remains unchanged with respect to guidance provided in the ANE Adopting Release regarding what constitutes arranging, negotiating, or executing security-based swaps.

<sup>57</sup> In connection with *de minimis* counting, this guidance applies to: (1) Exchange Act Rule 3a71–3(b)(1)(iii)(C), which requires the counting of security-based swap dealing transactions between non-U.S. counterparties that have been “arranged, negotiated, or executed” in the United States, 17 CFR 240.3a71–3(b)(1)(iii)(C); (2) Exchange Act Rule 3a71–3(b)(2), which addresses the counting of affiliate transactions described by paragraph (b)(1) (which includes the (b)(1)(iii)(C) requirement), 17 CFR 240.3a71–3(b)(2); (3) Exchange Act Rule 3a71–

under the Dodd-Frank Act.<sup>64</sup> One commenter warned that “market color” was “highly facts and circumstances-specific, complicating monitoring and surveillance by the Commission regarding whether dealer firms are appropriately classifying ANE transactions,”<sup>65</sup> as well as the exercise of the Commission’s anti-fraud authority<sup>66</sup> and would result in the Commission losing oversight over the vast majority of transactions that are currently classified as “arranging” or “negotiating.”<sup>67</sup> Finally, a commenter stated that the guidance would lead to “bifurcation of U.S. and non-U.S. markets” that would be “almost certain to impair liquidity and increase costs on U.S. counterparties” and lead to increased fragmentation.<sup>68</sup>

The Commission is not making additional changes in response to these comments. The Commission believes the guidance describes activities that are sufficiently limited and should not encourage entities (including U.S. entities) to restructure to avoid requirements applicable under the Dodd-Frank Act or to lead to market fragmentation. Moreover, contrary to one commenter’s suggestion, the Commission is not taking the position that market color activities are not within its jurisdiction.<sup>69</sup> Indeed, to the extent federal securities laws, including anti-fraud, apply to U.S. personnel’s provision of market color, nothing in this guidance affects requirements for U.S. personnel to comply with those laws. Moreover, any U.S. personnel who would have the requisite expertise to provide market color, likely would be associated persons of an entity registered with the Commission in an appropriate capacity, such as a security-based swap dealer or broker-dealer.

### *C. Conditional Exception to Required De Minimis Counting of Certain Dealing Transactions Arranged, Negotiated, or Executed by U.S. Personnel*

For the reasons discussed above in part A.2, and after carefully considering comments received, the Commission is adopting a conditional exception to the *de minimis* counting requirement of Rule 3a71-3(b)(1)(iii)(C), subject to

certain modifications from the proposal that are addressed below.<sup>70</sup>

#### 1. Registration and Ownership Status of the Entity With Which U.S. Personnel Is Associated

##### (a) Proposed Approach

The proposal set forth two alternatives that differed with regard to the registration status of the entity with which personnel engaged in arranging, negotiating, or executing activity within the United States is associated. Under Alternative 1, all such arranging, negotiating, or executing activity within the United States would have to be performed by personnel associated with an entity that is registered with the Commission as a security-based swap dealer.<sup>71</sup> Alternative 1 was predicated on the reasoning that requiring this U.S. activity to be conducted by personnel in their capacity as associated persons of a registered security-based swap dealer would help ensure that the U.S. activity would be subject to key security-based swap dealer requirements under Title VII, including requirements regarding supervision, books and records, trade acknowledgments and verifications, and business conduct standards. Alternative 2 as proposed was broader, allowing for the U.S. activity to be performed by personnel associated with an entity that is registered with the Commission as a broker (or, as with the first alternative, an entity that is registered as a security-

<sup>70</sup> As discussed below, the Commission is adopting a modified version of Alternative 2 of the proposed exception, which requires that the U.S. personnel at issue be associated either with a registered broker or with a registered security-based swap dealer. See Part II.C.1, *infra*.

This conditional exception to Rule 3a71-3(b)(1)(iii)(C) also would have ramifications to affiliate counting provisions of paragraph (b)(2) of Rule 3a71-3. Paragraph (b)(2) requires persons engaged in security-based swap transactions described in paragraph (b)(1) of the rule—which includes the transactions at issue—also to count certain dealing transactions of affiliates under common control, including transactions described in paragraph (b)(1)(iii) (unless, pursuant to Rule 3a71-4, the affiliate itself is a registered security-based swap dealer or a person in the process of registering as a security-based swap dealer). As a result, transactions subject to the proposed Rule 3a71-3(b)(1)(iii)(C) exception further would not be subject to the paragraph (b)(2) affiliate transaction counting requirement.

Also, Exchange Act Rule 3a71-5 excepts certain cleared anonymous transactions from the individual counting requirement of paragraph (b)(1) of Rule 3a71-3 (which includes the (b)(1)(iii)(C) requirement) and from the affiliate counting requirement of paragraph (b)(2), but the Rule 3a71-5 exception is unavailable to transactions arranged, negotiated, or executed by U.S. personnel. Because the exception to (b)(1)(iii)(C) will prevent the transactions at issue from triggering either the (b)(1) or (b)(2) counting requirements, the Rule 3a71-5 exception would not be relevant to those transactions.

<sup>71</sup> See Alternative 1—proposed Rule 3a71-3(d)(1)(i)(A).

based swap dealer).<sup>72</sup> The other proposed conditions to the two alternatives were intended to be functionally identical.<sup>73</sup>

Both proposed alternatives required that the registered entity (whether it is a registered security-based swap dealer or a registered broker) be a majority-owned affiliate of the non-U.S. person relying on the exception.<sup>74</sup> The affiliation condition in part reflected the expectation that financial groups that use the exception to avoid having to relocate their U.S.-based personnel (so as to avoid triggering security-based swap dealer registration) would use affiliated entities to satisfy the exception.<sup>75</sup> The affiliation condition also was intended to help guard against the risk that a financial group may seek to attenuate its responsibility for any shortcomings in the registered entity’s compliance with the conditions to the exception.<sup>76</sup> The proposal made use of a majority-ownership standard<sup>77</sup> to achieve that goal—rather than other measures of affiliation such as a common control standard or alternative ownership thresholds—to help ensure that the financial group has a significant interest in the registered entity, including the registered entity’s compliance with applicable requirements.<sup>78</sup>

##### (b) Commission Action

As discussed above in part II.A.2, “arranging,” “negotiating,” and “executing” are core components of security-based swap dealing activity.<sup>79</sup>

<sup>72</sup> See Alternative 2—proposed Rule 3a71-3(d)(1)(i)(A).

<sup>73</sup> There were certain technical differences between the two alternatives, to reflect the potential that, under Alternative 2, the U.S. activity could be conducted by a registered broker that is not also registered as a security-based swap dealer. See note 154, *infra*.

<sup>74</sup> See Alternatives 1 and 2—proposed Exchange Act Rule 3a71-3(d)(1)(i)(B).

<sup>75</sup> See Proposing Release, 84 FR at 24220, 24227.

<sup>76</sup> See *id*.

<sup>77</sup> Paragraph (a)(10) of Rule 3a71-3 defines the term “majority-owned affiliate” to encompass relationships whereby one entity directly or indirectly owns a majority interest in another, or whereby a third party directly or indirectly owns a majority interest in both, where “majority interest” is the right to vote or direct the vote of a majority of a class of voting securities of an entity, the power to sell or direct the sale of a majority of a class of voting securities of an entity, or the right to receive upon dissolution, or the contribution of, a majority of the capital of a partnership.

<sup>78</sup> See *id*.

<sup>79</sup> The “arranged, negotiated, or executed” criteria do not encompass non market-facing activity, such as:

Processing trades and other back-office activities; designing security-based swaps without engaging in market-facing activity in connection with specific transactions; preparing underlying documentation including negotiating master agreements (“as

<sup>64</sup> See Citadel letter at 5; see also Better Markets letter at 17.

<sup>65</sup> See Citadel letter at 5.

<sup>66</sup> See Better Markets letter at 21.

<sup>67</sup> See Citadel letter at 5.

<sup>68</sup> See Better Markets letter at 23–24.

<sup>69</sup> Nothing in the amendments or guidance should be interpreted as a limitation or further clarification of the “outer bounds of the agency’s cross-border jurisdiction.” See ISDA letter at 2.



Moreover, a non-U.S. person that, as part of its security-based swap dealing, “engages in market-facing activity using personnel located in the United States” would perform activities that fall within the security-based swap dealer definition “at least in part in the United States.”<sup>80</sup> The Commission is adopting Alternative 2—which requires that the “arranging, negotiating, or executing” activity in the United States be performed by personnel associated with either a registered security-based swap dealer or a registered broker<sup>81</sup>—but is modifying elements of Alternative 2 from the proposal in response to concerns raised by commenters.<sup>82</sup> In addition, the Commission is adopting, as proposed, the condition requiring that the registered entity be a majority-owned affiliate of the non-U.S. person relying on the exception.<sup>83</sup>

The Commission believes that its modified approach to Alternative 2 is preferable both to Alternative 1—which would have required the U.S. activity to

opposed to negotiating with the counterparty the specific economic terms of a particular security-based swap transaction”); and clerical and ministerial tasks such as entering executed transactions on a non-U.S. person’s books.

Proposing Release, 84 FR at 24215 (citing ANE Adopting Release, 81 FR at 8622). Further, the “arranged” and “negotiated” criteria do not include certain types of market-facing activity consistent with the “market color” guidance discussed in Part II.B, *supra*.

<sup>80</sup> See Proposing Release, 84 FR at 24208.

As noted in the Proposing Release, the exception applies only to the Rule 3a71–3(b)(1)(iii)(C) requirement for non-U.S. persons to count transactions that involve dealing activity in the United States. Rule 3a71–3 continues to require non-U.S. persons to count all of their security-based swap dealing transactions with U.S. person counterparties, all of their security-based swap dealing transactions that are guaranteed by their U.S. person affiliates, and certain dealing transactions of their affiliates. See Proposing Release, 84 FR at 24219 nn.102, 105.

<sup>81</sup> As noted in the Proposing Release, the exception would not be satisfied if the “arranging, negotiating, or executing” activity is conducted by a bank that has not registered as a broker due to exceptions for bank brokerage activity in the Exchange Act’s definition of “broker,” unless the bank is registered as a security-based swap dealer. See Proposing Release, 84 FR at 24226 n.166.

<sup>82</sup> See Exchange Act Rule 3a71–3(d)(1)(i)(A).

<sup>83</sup> The Commission received no comments specific to that proposed condition. As discussed in the Proposing Release, that condition is intended to help ensure that the financial group of the non-U.S. person has a significant interest in the registered security-based swap dealer or registered broker-dealer, to help promote appropriate compliance and oversight practices. See Proposing Release, 84 FR at 24220.

Paragraph (a)(10) to Rule 3a71–3 defines “majority-owned affiliate” to encompass a relationship whereby one entity directly or indirectly owns a majority interest in another, or where a third party directly or indirectly owns a majority interest in both, where “majority interest” reflects voting power, the right to sell, or the right to receive capital upon dissolution or the contribution of capital.

be performed by persons associated with a registered security-based swap dealer—and to Alternative 2 as proposed in supporting the use of “arranged, negotiated, or executed” criteria as part of *de minimis* counting, while avoiding negative consequences that otherwise may be associated with those criteria. The Commission also believes that the modified approach to Alternative 2 will provide important relief to non-U.S. persons from the potential need to register multiple entities. This conclusion in part reflects the reasons outlined below and in part reflects the fact that, although the registration status of the entity engaged in U.S. activity is different, the two alternatives are subject to other conditions that are nearly identical (as one commenter also noted).<sup>84</sup> Though the registered entity is not the counterparty to the transaction, the registered entity must comply with certain requirements for security-based swap dealers who act as counterparties to a security-based swap. The registered entity must comply with these requirements as if it were the counterparty to the transaction. Moreover, even when the U.S. activity at issue is conducted through a registered broker that is not also registered as a security-based swap dealer, the entity nonetheless must comply with these requirements as if it were a registered security-based swap dealer. These additional conditions protect both counterparties and the Commission’s ability to access information, as well as avoid the potential that the exception could be relied upon by non-U.S. persons that are not subject to certain minimum financial responsibility requirements.<sup>85</sup> These conditions also materially distinguish the modified version of Alternative 2 from alternatives that the Commission previously rejected when it incorporated “arranged, negotiated, or executed” criteria into the *de minimis* counting test.<sup>86</sup> Further, the

<sup>84</sup> See IIB/SIFMA letter at 10–11 (stating that under Alternative 2 the relevant transactions would be “no less protected” than under Alternative 1 because Alternative 2 would require compliance with the same conditions as Alternative 1).

<sup>85</sup> See *id.*

<sup>86</sup> In particular, when the Commission adopted rule amendments incorporating “arranged, negotiated, or executed” criteria as part of the *de minimis* counting test, and rejected an alternative approach based on the use of registered broker-dealers or U.S. banks:

The Commission noted that the broker-dealer framework does not apply to banks engaged in certain activities, which may include a significant proportion of security-based swap dealing activity, and stated that such an approach would effectively supplant Title VII security-based swap dealer regulation for a majority of dealing activity carried

Commission agrees with the commenters who supported Alternative 2 because it provides more flexibility to market participants to utilize U.S. personnel associated with either a registered broker or a registered security-based swap dealer.<sup>87</sup>

In adopting its modified approach to Alternative 2, the Commission also is mindful both of the comments in opposition to any exception as discussed above in Part II.A.2 and of one commenter’s view that the exception should not permit a non-U.S. firm to engage in security-based swap dealing activity in the United States without it or an affiliate being registered as a security-based swap dealer.<sup>88</sup> On

out in the United States with a “cobbled together” grouping of other requirements.

Proposing Release, 84 FR at 24220.

Alternative 2, in contrast, does not permit any carve-out for banks, and would require compliance with security-based swap dealer requirements in connection with key protections, including security-based swap dealer requirements regarding disclosure of risks, characteristics, material incentives, and conflicts of interest; suitability; fair and balanced communications; and trade acknowledgment and verification.

<sup>87</sup> See ISDA letter at 7–8 (“We believe that this flexible approach is important given that certain non-U.S. entities that enter into SBSs with other non-U.S. persons do not intend to register as an SBS in the United States.”); HSBC letter at 2–3 (noting that U.S. personnel associated with two registered security-based swap dealers and one registered broker-dealer engage in arranging, negotiating, or executing activity for non-U.S. entities in the HSBC group).

For the same reasons, and for the avoidance of doubt, the Commission is adopting as proposed the provision of Alternative 2 that permits the registered entity not to count against the *de minimis* thresholds for security-based swap dealer registration the transactions that its associated persons arrange, negotiate, or execute pursuant to the exception. See Exchange Act Rule 3a71–3(d)(3).

<sup>88</sup> See Citadel letter at 5–6 (“While we have concerns about permitting a dealer counterparty to engage in dealing activity using U.S.-based personnel without being appropriately registered with the Commission, in no event should the Commission adopt Alternative 2. This would allow a non-U.S. firm to engage in dealing activity in the U.S. in security-based swaps without either it, or an affiliate, being registered in the appropriate capacity with the Commission. As a result, key entity-level requirements designed specifically for firms engaged in security-based swap dealing activities would not apply. The Exchange Act is clear that “[i]t shall be unlawful for any person to act as a security-based swap dealer unless the person is registered as a security-based swap dealer with the Commission.” ANE Transactions constitute dealing activity in the U.S. and therefore should be taken into account for security-based swap dealer registration.” (footnote omitted)). The same commenter also stated that a failure to regulate the transactions at issue would create competitive disparities between U.S. and non-U.S. dealers with respect to the requirements applicable to the trading activities conducted by their U.S. personnel. See Citadel letter at 2. Finally, the commenter viewed Alternative 2 as allowing non-U.S. persons to “exit the Title VII regulatory regime without exiting the U.S. market” and to conduct “an unregistered security-based swap dealing business in the United

Continued



balance, however, the Commission is persuaded that the modified version of Alternative 2 will help to address the potential negative consequences that otherwise would be associated with the use of “arranged, negotiated, or executed” criteria as part of the *de minimis* counting test, while providing flexibility to market participants and promoting effective, efficient cross-border implementation of security-based swap dealer registration requirements in a manner consistent with the public interest.<sup>89</sup> Importantly, the exception does not apply to dealing activities involving U.S. counterparties or U.S. guarantees and thus does not permit market participants to avoid counting those transactions against the *de minimis* thresholds.<sup>90</sup>

#### (1) Minimum Capital Requirement

The Commission is modifying Alternative 2 from the proposal to require any broker that serves as the registered entity for purposes of the exception, and that is not approved to use models to compute deductions for market or credit risk, to maintain minimum net capital and establish and maintain risk management control systems as if the broker were also registered as a security-based swap dealer.<sup>91</sup> The Commission is mindful that, as proposed, Alternative 2 would have permitted a registered broker holding significantly less capital than a registered security-based swap dealer to serve as the registered entity for purposes of the exception. Indeed, one commenter favored Alternative 2 precisely because it would not require a broker to dually register as a security-based swap dealer, nor require it to hold the potentially higher minimum net capital required of registered security-

based swap dealer, if it wished to serve as the registered entity for purposes of the exception.<sup>92</sup> The lowest fixed-dollar minimum net capital requirement for registered broker-dealers is \$5,000, so long as the broker-dealer does not receive, owe, or hold customer funds or securities, does not carry customer accounts, and does not engage in certain other activities.<sup>93</sup> However, broker-dealers may be subject to significantly higher capital requirements depending on their businesses. For example, broker-dealers that carry customer funds or securities must maintain at least \$250,000 in net capital.<sup>94</sup> These minimum net capital requirements nonetheless are significantly lower than the minimum net capital required of brokers who are also registered security-based swap dealers. A broker dually registered as a security-based swap dealer must maintain at least \$20 million in net capital if it does not use models to compute deductions for market or credit risk (or the sum of an indebtedness-based ratio and up to eight percent of the risk margin amount, if that sum is greater than \$20 million).<sup>95</sup>

The Commission believes it is appropriate to require a broker serving as the registered entity for purposes of the exception to maintain minimum net capital at least equal to the minimum net capital requirements for brokers that are also security-based swap dealers. A minimum capital requirement for brokers serving as the registered entity for purposes of the exception ensures that every financial group that has foreign dealers engaged in U.S. security-based swap dealing activity pursuant to the exception—whether through a registered security-based swap dealer or a registered broker—must maintain the same amount of net capital. The Commission believes that this requirement reduces the potential for competitive disparities between firms that make use of a registered broker for purposes of the exception and those that make use of a registered security-based swap dealer. Reducing the potential for such disparities should help to mitigate one commenter’s concern that Alternative 2 could allow non-U.S. persons to “exit the Title VII regulatory regime without exiting the U.S. market” and to conduct “an unregistered

security-based swap dealing business in the United States.”<sup>96</sup> On balance, the Commission believes that these concerns regarding the potential for evasion of Title VII weigh more heavily than another commenter’s preference for the flexibility to use a minimally capitalized broker for purposes of the exception.<sup>97</sup> Accordingly, a broker not approved to use models may not serve as the registered entity for purposes of the exception unless it maintains at least as much net capital as that required for a broker that is also registered as a security-based swap dealer (*i.e.*, currently a minimum of \$20 million).<sup>98</sup> Because the use of a broker subject to higher capital requirements mitigates concerns regarding the potential for avoidance of Title VII, a broker that is approved to use models also could serve as the registered entity for purposes of the exception. In addition to complying with the other conditions to the exception, such brokers must comply with the higher minimum net capital and tentative net capital requirements that apply to them (*i.e.*, currently minimums of \$1 billion and \$5 billion, respectively).<sup>99</sup>

For analogous reasons, the Commission is modifying the proposal to require any broker that is not approved to use models and that serves as the registered entity for purposes of the exception to establish and maintain risk management control systems as if the entity also were a security-based swap dealer.<sup>100</sup> This condition imposes a new requirement to comply with portions of Rule 15c3–4 only for brokers who engage in “arranging, negotiating, or executing” activity pursuant to the exception and who are not approved to use models and are not dually registered as a security-based swap dealer or an OTC derivatives dealer. Other registered entities who may engage in “arranging, negotiating, or executing” activity pursuant to the exception—brokers who are approved to use models, non-model brokers who are dually registered as

States.” See Citadel letter at 2 (quoting the Proposing Release, 84 FR at 24215 nn.80–81).

<sup>89</sup> As discussed in Part II.A.2, *supra*, the Commission reiterates its conclusion that the “arranged, negotiated, or executed” criteria appropriately belong in the *de minimis* counting requirement.

<sup>90</sup> To be clear, the exception to the *de minimis* counting requirement does not reflect a determination by the Commission that these transactions are without the jurisdiction of the United States under Exchange Act Section 30(c). Consistent with the Commission’s view expressed in the ANE Adopting Release, transactions that are arranged, negotiated, or executed by personnel located in the United States in connection with a foreign person’s dealing activity constitute dealing activity within the United States. Accordingly, and as noted above, although the Commission is providing a limited exception from the requirement to count certain of these trades toward the *de minimis* threshold, the antifraud provisions of the federal securities laws and certain relevant Title VII requirements would continue to apply to the transactions subject to the exception.

<sup>91</sup> See Exchange Act Rule 3a71–3(d)(1)(i)(A)(1)–(2).

<sup>92</sup> See IIB/SIFMA letter at 10–11 & n.18 (arguing that the higher security-based swap dealer capital requirements would be disproportionate to the associated risk to the registered entity).

<sup>93</sup> See Exchange Act Rule 15c3–1(a)(2)(vi), 17 CFR 240.15c3–1(a)(2)(vi).

<sup>94</sup> See Exchange Act Rule 15c3–1(a)(2)(i), 17 CFR 240.15c3–1(a)(2)(i).

<sup>95</sup> See Exchange Act Rule 15c3–1(a)(10), 17 CFR 204.15c3–1(a)(10).

<sup>96</sup> See Citadel letter at 2 (quoting the Proposing Release, 84 FR at 24215 nn.80–81).

<sup>97</sup> See IIB/SIFMA letter at 10–11 & n.18.

<sup>98</sup> See Exchange Act Rule 15c3–1(a)(10), 17 CFR 240.15c3–1(a)(10). The minimum net capital requirement for a broker that serves as the registered entity for purposes of the exception does not lower the minimum net capital or tentative net capital that a broker must maintain if required pursuant to other applicable requirements.

<sup>99</sup> See Exchange Act Rule 15c3–1(a)(7), 17 CFR 240.15c3–1(a)(7).

<sup>100</sup> See Exchange Act Rule 3a71–3(d)(1)(i)(B)(2) (requiring compliance with Exchange Act Rule 15c3–1(a)(10)), which in turn requires compliance with portions of Exchange Act Rule 15c3–4, when the registered entity is a broker not approved to use models to compute deductions for market or credit risk).

either a security-based swap dealer or an OTC derivatives dealer, and stand-alone security-based swap dealers—are already required to comply with Rule 15c3–4.<sup>101</sup> As the Commission noted when adopting rules regarding risk management control systems for non-model-approved broker-dealers also registered as security-based swap dealers, “[t]he Commission believes that establishing and maintaining a strong risk management control system is necessary for entities engaged in security-based swap business.”<sup>102</sup> Appropriate risk management controls help a firm to reduce its risk of significant loss, which also reduces the risk of spreading the losses to other market participants or throughout the financial markets as a whole.<sup>103</sup> The Commission recognizes that service as the registered entity for purposes of the exception would not by itself be expected to create the same level of market or credit risk for a registered broker as it would for dealing entities that hold positions in security-based swaps. The Commission would expect the registered broker to establish such controls appropriate to the risk it undertakes. If the registered broker does not undertake any other activities other than arranging, negotiating, or executing transactions for its affiliates, the system of internal risk management controls regarding market and credit risk could, for example, entail guidelines, policies, and procedures that the broker does not undertake activities that create market or credit risk. Accordingly, the Commission is requiring that a broker that is not approved to use models and that serves as the registered entity for the purposes of the exception, must comply with Rule 15c3–1(a)(10)(ii) as if that entity were registered with the Commission as a security-based swap dealer.

<sup>101</sup> See Exchange Act Rule 15c3–1(a)(7) (requiring brokers approved to use models to comply with portions of Exchange Act Rule 15c3–4); Exchange Act Rule 15c3–1(a)(10) (requiring brokers not approved to use models who are dually registered as security-based swap dealers to comply with portions of Exchange Act Rule 15c3–4); Exchange Act Rule 15c3–4 (requiring compliance by OTC derivatives dealers); Exchange Act Rule 18a-1(f) (requiring security-based swap dealers to comply with portions of Exchange Act Rule 15c3–4).

<sup>102</sup> Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital and Segregation Requirements for Broker-Dealers, Exchange Act Release No. 86175 (June 21, 2019), 84 FR 43872, 43907 (Aug. 22, 2019) (“Capital, Margin, and Segregation Adopting Release”).

<sup>103</sup> See *id.*

## (2) Limited Exemption From Broker Registration

The Commission is modifying Alternative 2 from the proposal to include, as an ancillary to the conditional exception, a limited exemption from the broker registration requirement in Section 15(a) of the Exchange Act for “arranging, negotiating, or executing” activity that is conducted in compliance with the exception and that is with or for a counterparty that is an eligible contract participant. Consistent with the Proposing Release, the Commission also recognizes that the “arranging, negotiating, or executing” activity subject to the exception generally would constitute “broker” activity under the Exchange Act.<sup>104</sup> As a result, a security-based swap dealer not already registered as a broker that serves as the registered entity for purposes of the exception, and its associated persons, could be required to register as brokers pursuant to Section 15(a) of the Exchange Act unless they can avail themselves of an exception from broker status or an exemption from broker registration.<sup>105</sup> One commenter suggested that the Commission exempt from broker registration any registered security-based swap dealer whose only securities brokerage activity is the “arranging, negotiating, or executing” activity that its U.S. personnel conducts in connection with the exception.<sup>106</sup> That commenter noted that a security-based

<sup>104</sup> See Proposing Release, 84 FR at 24220. Although the Dodd-Frank Act excludes from the Exchange Act definition of “dealer” persons who engage in security-based swaps with or for persons who are eligible contract participants, see Section 3(a)(5) of the Exchange Act, 15 U.S.C. 78c(a)(5), as amended by Section 761(a)(1) of the Dodd-Frank Act, it does not include comparable provisions for persons who act as brokers in security-based swaps. Because security-based swaps, as defined in Section 3(a)(68) of the Exchange Act, are included in the Exchange Act Section 3(a)(10) definition of “security,” persons who act as brokers in connection with security-based swaps must, absent an exception or exemption, register with the Commission as a broker pursuant to Exchange Act Section 15(a), and comply with the Exchange Act’s requirements applicable to brokers. See Intermediary Definitions Adopting Release, 77 FR at 30597 n.9.

<sup>105</sup> See Proposing Release, 84 FR at 24220. Exchange Act Section 15(a) requires persons who engage in brokerage activities involving securities (including security-based swaps) to register with the Commission unless they can avail themselves of an exception or exemption from the registration requirement. The definition of “broker” in Exchange Act Section 3(a)(4) generally encompasses persons engaged in the business of effecting transactions in securities for the account of others, but does not encompass banks that are engaged in certain activities, which may include a significant portion of banks’ security-based swap dealing activity. See Proposing Release, 84 FR at 24209 n.21 (citing ANE Adopting Release, 81 FR at 9619).

<sup>106</sup> See IIB/SIFMA letter at 11.

swap dealer not dually registered as a broker-dealer and approved to use models to compute deductions for market or credit risk is subject to a minimum net capital requirement of \$20 million and a minimum tentative net capital requirement of \$100 million, versus minimum requirements of \$1 billion and \$5 billion, respectively, for a broker-dealer approved to use models.<sup>107</sup> The Commission believes that applying the heightened broker-dealer capital requirements to all security-based swap dealers approved to use models who serve as the registered entity for purposes of the exception could limit the usefulness of the exception, and is adopting the limited exemption from broker registration to avoid that potential outcome.<sup>108</sup>

At the same time, the Commission is mindful that the exception applies to “arranging, negotiating, or executing” activity with both eligible contract participants and non-eligible contract participants. As noted above, the exemption from broker registration applies only to “arranging, negotiating, or executing” activity that is conducted in compliance with the exception and that is with or for a counterparty that is an eligible contract participant. The Commission believes that requiring broker registration with respect to “arranging, negotiating, and executing” activity with or for a counterparty that is not an eligible contract participant is consistent with the heightened protections that Congress applied to security-based swap transactions with or for non-eligible contract participants.<sup>109</sup>

<sup>107</sup> See IIB/SIFMA letter at 11 n.18; Exchange Act Rules 18a–1(a) and 15c3–1(a)(7), (10), 17 CFR 240.18a–1(a) and 15c3–1(a)(7), (10).

<sup>108</sup> The Commission also acknowledges that the exemption creates the potential for competitive disparities between market participants who engage in “arranging, negotiating, or executing” activity with non-U.S. eligible contract participants pursuant to the exception, for whom an exemption from broker registration potentially would be available, and market participants who engage in similar activity with U.S. persons, for whom the Rule 3a71–3 exception is not available and thus the related exemption from broker registration also would not apply. For example, an exemption from broker registration available only with respect to “arranging, negotiating, or executing” activity with non-U.S. persons could create an incentive for market participants to provide greater liquidity and/or liquidity at a lower cost to non-U.S. eligible contract participants than to U.S. eligible contract participants. The limitations on the availability of the exemption should minimize the potential for these competitive disparities while also making the exception from the *de minimis* counting standard a practicable alternative.

<sup>109</sup> In its Title VII statutory framework, Congress applied heightened protections for security-based swap counterparties who are not eligible contract participants, requiring, for example, security-based swap transactions with or for a person who is not

Finally, Exchange Act Rule 10b–10 requires brokers to provide certain disclosures in connection with “transactions” that involve “customers” of the broker.<sup>110</sup> Although many of the disclosures required by Rule 10b–10 would be included in a trade acknowledgment and verification<sup>111</sup> delivered pursuant to the condition discussed in Part II.C.2 below, some of the Rule 10b–10-required disclosures may not duplicate the information provided in a trade acknowledgment and verification. These additional disclosures required under Rule 10b–10 provide the customer with important information regarding the brokerage activity.<sup>112</sup> The Commission thus believes that the limited exemption from broker registration should be conditioned upon the security-based swap dealer providing these non-duplicative disclosures to the customer if Rule 10b–10 otherwise would apply to the activity subject to the exception.<sup>113</sup> Accordingly, pursuant to

an eligible contract participant to be effected only on a registered national securities exchange. See Exchange Act Section 6(l), 15 U.S.C. 78f(l), as added by Section 763(e) of the Dodd-Frank Act. Congress’ Title VII statutory framework also includes an exception from the definition of dealer for persons engaged in the business of buying and selling security-based swaps with or for eligible contract participants, but provides no exception from the dealer definition for persons engaged in the business of buying and selling security-based swaps with or for non-eligible contract participants. See Exchange Act Section 3(a)(5), 15 U.S.C. 78c(a)(5), as amended by Section 761(a)(1) of the Dodd-Frank Act.

<sup>110</sup> See Exchange Act Rule 10b–10(a), 17 CFR 240.10b–10(a) (prohibiting a broker or dealer to effect for or with an account of a customer any transaction in, or to induce the purchase or sale by such customer of, a security unless the broker or dealer delivers a written confirmation at or before completion of the transaction).

<sup>111</sup> While Rule 15Fi–2 requires a trade acknowledgment to disclose all terms of the security-based swap transaction, see Exchange Act Rule 15Fi–2(c), 17 CFR 240.15Fi–2(c), Rule 10b–10 includes provisions requiring disclosures that may not form part of the terms of the security-based swap transaction between the relying entity and its counterparty, including the capacity in which the broker (who would not be party to the transaction) is acting, see Exchange Act Rule 10b–10(a)(2), CFR 240.10b–10(a)(2), and the fact that the broker is not a member of the Securities Investor Protection Corporation, if such is the case, see Exchange Act Rule 10b–10(a)(8), 17 CFR 240.10b–10(a)(8).

<sup>112</sup> For example, customers may use disclosures regarding the capacity in which the broker is acting and membership in the Securities Investor Protection Corporation to determine whether the broker is able to meet the customer’s needs.

<sup>113</sup> For the reasons discussed in Part II.C.2, *infra*, these disclosures may be delivered to the customer in accordance with the time and form requirements set forth in Rule 15Fi–2(b)–(c), rather than in accordance with the slightly different timing standards set forth in Rule 10b–10. If the registered security-based swap dealer relying on this exemption from registration as a broker makes a good faith effort to comply with the requirement to deliver these disclosures to the customer as and

Section 15(a)(2) of the Exchange Act, the Commission deems consistent with the public interest and the protection of investors to adopt a limited exemption from the broker registration requirements of Section 15(a)(1) of the Exchange Act for “arranging, negotiating, or executing” activity conducted pursuant to the exception with or for eligible contract participants. New paragraph (d)(4) of Rule 3a71–3 provides that a registered security-based swap dealer that serves as the registered entity for purposes of the exception and its associated persons shall not be subject to registration as a broker pursuant to Section 15(a)(1) solely because that registered entity or the associated person engages in “arranging, negotiating, or executing” activity pursuant to the exception with or for an eligible contract participant, provided that (i) the conditions to the availability of the exception are satisfied in connection with such activities and (ii) if Rule 10b–10 would apply to an activity subject to the exception, the registered security-based swap dealer provides to the customer<sup>114</sup> the disclosures required by Rule 10b–10(a)(2) (excluding Rule 10b–10(a)(2)(i)–(ii)) and Rule 10b–10(a)(8) in accordance with the time and form requirements set forth in Rule 15Fi–2(b)–(c), or, alternatively, promptly after discovery of any defect in the registered security-based swap dealer’s good faith effort to comply with such requirements.

### (3) Limit on Use of the Exception for Covered Inter-Dealer Security-Based Swaps and Related Notice and Recordkeeping Provisions

The final rule limits the availability of the exception in connection with certain inter-dealer security-based swaps, and provides for related notices and recordkeeping requirements to facilitate implementation of this limit. In particular, the final rule provides that the availability of the exception is conditioned on the aggregate gross notional amount of certain inter-dealer security-based swap positions connected with dealing activity subject to the exception over the course of the immediately preceding 12 months remaining below \$50 billion.<sup>115</sup> If that

when required, the failure to do so will not make the exemption from broker registration unavailable so long as the registered security-based swap dealer delivers the disclosures to the customer promptly after discovery of the defect in compliance. See Exchange Act Rule 3a71–3(d)(4).

<sup>114</sup> For example, the Rule 10b–10 disclosures could be provided as part of the disclosures required pursuant to the disclosure condition in Rule 3a71–3(d)(1)(ii)(B)(1) discussed below.

<sup>115</sup> See Exchange Act Rule 3a71–3(d)(1)(vii).

threshold is exceeded, the exception will not be available and all of the relevant transactions (including transactions below the \$50 billion threshold) must be counted against the *de minimis* thresholds to the “security-based swap dealer” definition.<sup>116</sup> The rules further condition the availability of the exception on the registered entity whose associated persons conduct the “arranging, negotiating, or executing” activity in the United States filing a notice with the Commission prior to commencing such activity.<sup>117</sup> Finally, the registered entity must comply with certain recordkeeping requirements designed to facilitate compliance with this \$50 billion threshold.<sup>118</sup>

### (a) Purpose of the Limit

In its releases adopting rules applying Title VII requirements to cross-border transactions in 2014 and 2016, the Commission recognized and sought to reduce the risk that market participants might restructure their business or develop novel business structures to permit them to characterize their security-based swap dealing activity as occurring outside the United States.<sup>119</sup> Section 30(c) of the Exchange Act provides the Commission with authority to adopt rules that apply to a “person that transacts a business in security-based swaps without the jurisdiction of the United States” if it determines that such rules are “necessary or appropriate to prevent the evasion” of any Title VII requirements.<sup>120</sup> The Commission invoked this authority in connection with several of its cross-border requirements.<sup>121</sup> In particular, the Commission identified this provision as the basis for adopting a rule requiring conduit affiliates to count certain of their dealing transactions against the *de minimis* threshold.<sup>122</sup> The Commission

<sup>116</sup> See Exchange Act Rule 3a71–3(d)(6)(iii).

<sup>117</sup> See Exchange Act Rule 3a71–3(d)(1)(vi).

<sup>118</sup> See Exchange Act Rule 3a71–3(d)(1)(iii)(B)(2).

<sup>119</sup> See Cross-Border Adopting Release, 79 FR at 47363–64; ANE Adopting Release, 81 FR at 8609.

<sup>120</sup> Exchange Act Section 30(c), 15 U.S.C. 78dd(c).

<sup>121</sup> See, e.g., Cross-Border Adopting Release, 79 FR at 47291–92 (interpreting the Commission’s anti-evasion authority under section 30(c) of the Exchange Act and including anti-evasion among the principles informing the Commission’s approach to cross-border regulation of these markets).

<sup>122</sup> See Cross-Border Adopting Release, 79 FR at 47314. A conduit affiliate is “a non-U.S. affiliate of a U.S. person that enters into security-based swaps with non-U.S. persons, or with certain foreign branches of U.S. banks, on behalf of one or more of its U.S. affiliates (other than U.S. affiliates that are registered as security-based swap dealers or major security-based swap participants), and enters into offsetting transactions with its U.S. affiliates to transfer the risks and benefits of those security-based swaps.” *Id.* The Commission noted in that release that “[t]he conduit affiliate concept serves as a prophylactic anti-evasion measure” and that it

also explained that several other of its cross-border requirements that apply to activity occurring in the United States are “necessary or appropriate as a prophylactic measure to help prevent the evasion of the provisions of the Exchange Act that were added by the Dodd-Frank Act, and thus help ensure that the relevant purposes of the Dodd-Frank Act are not undermined.”<sup>123</sup>

Similarly, when the Commission adopted the “arranged, negotiated, or executed” test, it recognized the possibility that financial groups might seek to avoid this requirement by having personnel outside the United States perform market-facing activities under the direction of personnel located in the United States.<sup>124</sup> It addressed this concern by explaining that “arranging, negotiating, and executing” as used in Exchange Act Rule 3a71–3 “also include directing other personnel to arrange, negotiate, or execute a particular security-based swap.”<sup>125</sup> The Commission explained that it “would view personnel located in a U.S. branch or office who direct personnel not located in the United States to arrange, negotiate, or execute a security-based swap transaction as themselves arranging, negotiating, or executing the transaction.”<sup>126</sup> Consequently, “sales and trading personnel of a non-U.S. person who are located in the United States cannot avoid application of this rule by simply directing other personnel to carry out dealing activity.”<sup>127</sup>

The Commission recognizes that the exception it is adopting may also create incentives for financial groups to restructure their business to avoid the application of certain Title VII requirements in some circumstances. Available data suggests that the majority

of inter-dealer transaction activity in North American corporate single-name credit default swaps involved at least one non-U.S.-domiciled dealer in 2017.<sup>128</sup> Although the data also suggests that these non-U.S.-domiciled dealers would be likely to register as security-based swap dealers even absent a requirement to count their transactions arranged, negotiated, or executed by U.S. personnel,<sup>129</sup> a financial group could restructure its dealing business in response to this exception in such a way that it could carry out this inter-dealer business in significant part in one or more unregistered non-U.S. dealers, while continuing to arrange, negotiate, or execute transactions using personnel located in the United States. Further, as the Commission recognized in proposing the exception, U.S. dealing entities also may use this type of exception from the counting requirement to reduce the application of Title VII requirements to their transactions.<sup>130</sup> Two commenters expressed similar concerns that the exception as proposed could allow firms to structure large portions of their business to avoid Title VII while continuing to pose risks to the U.S. financial system.<sup>131</sup> Allowing this type of restructuring of the inter-dealer business could have potentially undesirable effects on the underlying

credit and equity markets in the United States.

To help to mitigate these concerns, the Commission is imposing a limit on covered inter-dealer security-based swap transactions that a non-U.S. dealer or its affiliates may conduct in reliance on the exception. In adopting this limit, the Commission is balancing the concerns discussed above regarding the potential negative consequences associated with both the “arranging, negotiating, or executing” counting standard and the exception as proposed. The Commission is choosing not to apply the limit to non-inter-dealer security-based swaps at this time because it is not clear that a broader limitation is necessary to avoid the potential negative consequences associated with the exception. Rather, the Commission believes that a limit on inter-dealer security-based swaps will mitigate concerns regarding the proposed exception without unduly restricting the non-inter-dealer security-based swap market. Taken as a whole, the limit and related notice and recordkeeping provisions are designed to focus the availability of the exception in a manner that will promote the exception’s benefits for market efficiency as addressed above, but that also will help reduce incentives for financial groups to restructure their business to avoid the application of certain Title VII requirements.

The limit on use of the exception applies to any non-U.S. person, regardless of whether it is affiliated with a U.S. or non-U.S. financial group, as the Commission has concerns about potential evasive activity on the part of non-U.S. affiliates of U.S. financial groups as well as of non-U.S. financial groups. The Commission is concerned that failing to apply the same limit to non-U.S. dealers relying on the exception, whether they belong to U.S. or non-U.S. financial groups, could distort competition in this market. Moreover, the regulatory status of the relying entity’s counterparty does not impact these potentially undesirable effects, and thus is not relevant to application of the \$50 billion limit.<sup>132</sup>

<sup>132</sup> In many cases, the non-U.S. person counterparty may be recognized, registered, or regulated under U.S. or foreign law as a security-based swap dealer, swap dealer, bank, broker-dealer, or futures commission merchant, but the regulatory status of the counterparty is not relevant to the \$50 billion limit, as a transaction will need to be counted toward that limit even if the counterparty is an unregulated entity.

Similarly, the regulatory status of the relying entity and its affiliates also is irrelevant for purposes of the \$50 billion limit. The relying entity is required to count toward its *de minimis*

did “not believe that any entities currently act as conduit affiliates in the security-based swap market.” *Id.* at 47315.

<sup>123</sup> The Commission stated in these releases that, apart from the *de minimis* counting requirements applicable to conduit affiliates, the rules it adopted apply to conduct occurring within the United States and thus are within the Commission’s authority apart from this anti-evasion provision. However, it went on to state that it also viewed these rules as necessary or appropriate as an anti-evasion measure under Section 30(c) of the Exchange Act. *See, e.g.*, Cross-Border Adopting Release, 79 FR at 47302 n.186 (definitions of “foreign branch” and “transaction conducted through a foreign branch”); *id.* at 47309 n.262 (definition of “principal place of business”); *id.* at 47320 n.365 (requirement that non-U.S. persons count dealing transactions with U.S. persons toward their *de minimis* thresholds); ANE Adopting Release, 81 FR at 8615 n.158 (requirement that non-U.S. persons count transactions in connection with their dealing activity that are arranged, negotiated, or executed by personnel located in the United States).

<sup>124</sup> ANE Adopting Release, 81 FR at 8623.

<sup>125</sup> *Id.*

<sup>126</sup> *Id.*

<sup>127</sup> *Id.*

<sup>128</sup> Using data obtained from the DTCC Derivatives Repository Limited Trade Information Warehouse (*see* Part IV.A.1, *infra*), the Commission estimates that approximately 82% of the notional amount of bilateral (*i.e.*, uncleared) inter-dealer transactions referencing North American single-name corporate underliers involve at least one non-U.S.-domicile dealer.

<sup>129</sup> Each of these dealers currently transacts significant volumes security-based swaps with U.S. persons, including with counterparties that are themselves not dealers, which they would be required to count against their *de minimis* thresholds. These dealers would exceed the \$8 billion *de minimis* threshold that applies to credit default swap transactions based solely on transactions with U.S. persons.

<sup>130</sup> *See* Proposing Release, 84 FR at 24219 (“In making this proposal, the Commission is mindful that U.S.-based dealing entities may use this type of exception to structure their booking practices to manage the application of Title VII to their security-based swap dealing business—*e.g.*, by booking dealing transactions with non-U.S. counterparties into their non-U.S. affiliates, to reduce the application of Title VII security-based swap dealer requirements to those transactions.”).

<sup>131</sup> *See* Better Markets letter at 1, 25 (noting that the proposed exception could “facilitate[e] evasion or avoidance of critical pillars of the [security-based swap] framework” and expressing concern that this framework must “reach far enough” to prevent restructuring that would “expos[e] [the] U.S. financial system and U.S. taxpayers to the risks arising from [security-based swap] activities”); AFR letter at 1–3 (noting that the proposed exception could prompt U.S.-based financial groups to “easily avoid swap dealer designation for large shares of their U.S.-related business”).

Continued

This limit thus applies without regard to whether either counterparty is affiliated with a U.S. or non-U.S. financial group and regardless of the regulatory status of the relying entity's counterparty. The \$50 billion limit should help ensure that a relying entity, together with its non-U.S. person affiliates, cannot use the exception to enter into unlimited transactions with other firms that themselves could engage in dealing activity subject to the exception. Under this approach, the Commission believes these financial groups will have less incentive to structure their businesses to avoid regulation of their inter-dealer business under the relevant Title VII requirements. For example, with this limitation, a financial group will not be able to use the exception to move its inter-dealer business with non-U.S. persons involving "arranging, negotiating, or executing" activity above the \$50 billion threshold to an unregistered non-U.S. affiliate.<sup>133</sup> Moreover, the requirement to aggregate transactions of covered affiliates, as discussed below, ensures that the \$50 billion threshold applies to all unregistered non-U.S. persons in a financial group and thus prevents the financial group from allocating its inter-dealer transactions to multiple unregistered non-U.S. affiliates to avoid registration of any affiliate.

The Commission intends to monitor changes in the market in response to this exception and initially will use the report that Commission staff is required to produce under Exchange Act Rule

thresholds all covered inter-dealer security-based swap positions connected with its own or an affiliate's "arranging, negotiating, or executing" dealing activity subject to the exception, regardless of the application of non-U.S. regulatory regimes to those transactions.

<sup>133</sup> For the avoidance of doubt, the \$50 billion limit does not apply transactions that are not eligible for the exception (or for which reliance on the exception is not sought). For example, if a non-U.S. person ("counterparty 1") enters into a security-based swap with a U.S. person ("counterparty 2"), even if that U.S. person is an affiliate of a registered entity that acts pursuant to the exception, counterparty 1 would not be required to count that transaction towards its \$50 billion limit, as transactions with U.S. persons are not eligible for the exception. Counterparty 1 would, of course, count such a transaction toward the *de minimis* thresholds for registration as a security-based swap dealer.

Similarly, if a non-U.S. person ("counterparty 1") enters into a security-based swap that is "arranged, negotiated, or executed" by U.S. personnel with a non-U.S. person ("counterparty 2"), for which counterparty 1 does not seek reliance on the exception, counterparty 1 would not be required to count that transaction towards its \$50 billion limit, even if counterparty 1 relies on the exception for other transactions and even if counterparty 2 is relying on the exception for that transaction. Counterparty 1 would, of course, count such a transaction toward the *de minimis* thresholds for registration as a security-based swap dealer.

3a71-2A to analyze the changes. Commission staff will repeat this analysis at least once every five years. If this initial analysis or subsequent monitoring suggests that firms are using the exception to avoid the *de minimis* counting requirement in a manner that is inconsistent with the statutory and regulatory objectives of Title VII or that non-U.S. persons are entering into disproportionately large volumes of security-based swaps pursuant to the exception, the Commission may determine that it is necessary to consider amendments to the exception or to the underlying counting requirements, including possible amendments pursuant to its anti-evasion authority in Exchange Act Section 30(c).

#### (b) Scope of the Limit and Related Recordkeeping Requirement

Under the final rule, the exception would be available to a relying entity only if the aggregate gross notional amount of covered inter-dealer security-based swap positions connected with dealing activity subject to the exception over the course of the immediately preceding 12 months does not exceed \$50 billion.<sup>134</sup> Covered inter-dealer security-based swaps are those that are between, on the one hand, the non-U.S. person relying on the exception, and, on the other hand, a non-U.S. person that is either (1) a registered entity that has filed with the Commission a notice that its associated persons may conduct "arranging, negotiating, or executing" activity pursuant to the exception<sup>135</sup> or (2) an affiliate of such a registered entity.<sup>136</sup> A relying entity would count towards this \$50 billion threshold two types of covered inter-dealer security-based swaps: (1) The covered inter-dealer security-based swap positions connected with the relying entity's

<sup>134</sup> See Exchange Act Rule 3a71-3(d)(1)(vii) (limitation on application of the exception to covered inter-dealer security-based swaps); Exchange Act Rule 3a71-3(a)(13) (definition of covered inter-dealer security-based swap); Exchange Act Rule 3a71-3(d)(6)(i) (description of the persons whose covered inter-dealer security-based swaps count towards the limitation).

<sup>135</sup> If the counterparty to the security-based swap is a registered entity that is a U.S. person, then the exception would not be available for the security-based swap and the limitation on covered inter-dealer security-based swaps conducted pursuant to the exception thus would not apply.

<sup>136</sup> Exchange Act Rule 3a71-3(a)(13) defines covered inter-dealer security-based swaps to include transactions with a registered entity that has filed a notice pursuant to Rule 3a71-3(d)(1)(vi) and with an affiliate of such a registered entity. As discussed more fully below, Rule 3a71-3(d)(1)(vi) requires the registered entity to file a notice with the Commission that its associated persons may conduct "arranging, negotiating, or executing" activity pursuant to the exception.

dealing activity subject to the exception and (2) the covered inter-dealer security-based swap positions connected with dealing activity subject to the exception engaged in by non-U.S. person affiliates of the relying entity.<sup>137</sup> The Commission is applying the \$50 billion limit to security-based swaps involving the relying entity's non-U.S. person affiliates because failure to count such affiliates could allow a financial group to structure its inter-dealer security-based swap business to avoid the limit. For example, absent a requirement to count the transactions of a relying entity's own affiliates, a financial group could organize a new legal entity to conduct inter-dealer security-based swap business each time a relying entity approached the \$50 billion limit. Similarly, the requirement to count transactions with affiliates of another financial group's registered entity includes the non-U.S. majority-owned affiliates relying on the exception as well as other non-U.S. affiliates who do not rely on the exception. Absent such a requirement, a relying entity could conduct unlimited security-based swap business with the other financial group, so long as the counterparty is an entity not relying on the exception. The \$50 billion limit applies to transactions of affiliates as described above to avoid such outcomes.

To identify the covered inter-dealer security-based swap positions connected with the relying entity's dealing activity subject to the exception, a relying entity first must determine whether a security-based swap is connected with its own dealing activity subject to the exception and, if it is, then it must determine whether the counterparty is a non-U.S. person that is either (i) a registered entity whose associated persons conduct "arranging, negotiating, or executing" activity pursuant to the exception or (ii) an affiliate of such a registered entity. The Commission believes that a relying entity will be able to structure its operations to answer this first question, as it and its registered affiliate must comply with certain recordkeeping conditions discussed below in connection with the specific "arranging, negotiating, or executing" activity that is subject to the exception. To assist the relying entity in determining whether its counterparty is a registered entity whose associated persons act pursuant

<sup>137</sup> See Exchange Act Rule 3a71-3(d)(1)(vii), (d)(6). This threshold extends to dealing transactions by affiliates of the relying entity to guard against a firm's evasion of the threshold by dividing transactions among multiple affiliates.

to the exception or an affiliate of such a registered entity, the final rules condition the availability of the exception on a registered entity first filing with the Commission a notice that its associated persons may conduct activity pursuant to the exception.<sup>138</sup> Further, the final rules provide a safe harbor from the limitation for any security-based swap if the relying entity reasonably determines at the time of execution of the security-based swap that its counterparty is neither another firm's registered entity nor an affiliate of such a registered entity.<sup>139</sup> For example, the Commission believes that it would be reasonable for a relying entity (or its affiliate) to determine a security-based swap is not a covered inter-dealer security-based swap if the relying entity or an affiliate requests at least quarterly, and diligently pursues, a list of affiliates from each registered entity whose name appears on the Commission's website and the relying entity determines at the time of execution of the security-based swap that the name of the counterparty to the security-based swap does not appear on any such list in the relying entity's possession at that time.<sup>140</sup> Further, the Commission believes that it would be reasonable for financial groups to produce and share a single list of their affiliates for use in connection with the \$50 billion limit and in connection with determining eligibility for exceptions to the Commission's requirements for security-based swap dealers to collect initial margin from counterparties.<sup>141</sup>

<sup>138</sup> See Exchange Act Rule 3a71-3(d)(1)(vi). This notice must be filed before an associated person of the registered entity commences any "arranging, negotiating, or executing" activity pursuant to the exception. The notice must be submitted to the electronic mailbox described on the Commission's website at [www.sec.gov](http://www.sec.gov) at the "ANE Exception Notices" section. The Commission will post the notice on its website. A registered entity whose associated persons will no longer conduct "arranging, negotiating, or executing" activity pursuant to the exception may request that the Commission remove such notice from its website by sending a message to the same electronic mailbox.

<sup>139</sup> See Exchange Act Rule 3a71-3(a)(13).

<sup>140</sup> If a relying entity executes a security-based swap with a counterparty that, at the time of execution, the relying entity reasonably believes is not an affiliate of another firm's registered entity, the relying entity need not later re-characterize the security-based swap as a covered inter-dealer security-based swap, even if it later discovers that its counterparty is an affiliate of another firm's registered entity.

<sup>141</sup> The Commission's margin rules for non-bank security-based swap dealers include an exception from the requirement to collect initial margin for non-cleared security-based swaps when certain exposures of the security-based swap dealer and its affiliates to the counterparty and its affiliates do not exceed \$50 million. See Exchange Act Rule 18a-3(c)(1)(iii)(H)(1), 17 CFR 240.18a-3(c)(1)(iii)(H)(1); see also Capital, Margin, and Segregation Adopting Release, 84 FR at 43925-26 & nn.522-523 (citing

The relying entity also must include in its calculation of covered inter-dealer security-based swap positions subject to the \$50 billion limit all positions connected with dealing activity subject to the exception that its non-U.S. person affiliates engage in with another non-U.S. person that is either (i) a registered entity whose associated persons conduct "arranging, negotiating, or executing" activity pursuant to the exception or (ii) an affiliate of such a registered entity. The relying entity need not, however, include in this calculation the positions of its own non-U.S. person affiliate that is in the process of registering with the Commission as a security-based swap dealer.<sup>142</sup> This exclusion from the \$50 billion limit ensures that a financial group does not lose the ability to make use of the exception as a result of the dealing activity of an entity that will register with the Commission. To assist the relying entity in obtaining information needed to determine the volume of its affiliates' transactions subject to the limit, and to assist the Commission in reviewing compliance with the limit, each registered entity whose associated persons may conduct "arranging, negotiating, or executing" activity pursuant to the exception must obtain from the relying entity documentation regarding the relying entity's compliance with the limit.<sup>143</sup> The registered entity must maintain this documentation for not less than three years following the "arranging, negotiating, or executing" activity subject to the exception, the first two years in an easily accessible place.<sup>144</sup>

#### (c) Impact of Breaching the Limit

Under the Commission's rules, a person not registered as a security-based swap dealer is deemed not to be a security-based swap dealer if the security-based swap dealing activity in which the person, or any other entity controlling, controlled by or under common control with that person, engages over the course of the immediately preceding twelve months falls below certain *de minimis*

thresholds.<sup>145</sup> The exception serves to exclude certain transactions "arranged, negotiated, or executed" by U.S. personnel<sup>146</sup> from the list of transactions that an entity otherwise must count against these *de minimis* thresholds.<sup>147</sup> If a relying entity exceeds the \$50 billion limit, two key consequences will result. First, as of the date the \$50 billion limit is breached, new Rule 3a71-3(d)(6)(ii)(A) prohibits the relying entity from relying on the exception for future security-based swap transactions.<sup>148</sup> The exception will be unavailable for future security-based swap transactions without regard to whether the transaction is or is not a covered inter-dealer security-based swap. Second, as of the date that the \$50 billion limit is breached, the relying entity would have to begin to count certain transactions subject to the exception against the *de minimis* thresholds. New Rule 3a71-3(d)(6)(ii)(B) requires the relying entity to count against the *de minimis* thresholds all covered inter-dealer security-based swap positions connected with dealing activity subject to the exception in which the entity or certain affiliates engaged over the course of the immediately preceding twelve months. This requirement applies to all of these covered inter-dealer security-based swap positions, including the portion that falls below the \$50 billion limit.<sup>149</sup> Because each of the *de minimis* thresholds is significantly lower than \$50 billion, as a practical matter a relying entity that exceeds \$50 billion in relevant covered inter-dealer security-based swap positions over the immediately preceding twelve months also generally should breach one or more of the *de minimis* thresholds and be required to register with the Commission as a security-based swap dealer. As of the date that the \$50 billion limit is breached, the relying entity would begin to include in its calculation of security-based swap positions subject to the *de minimis* thresholds all of the relevant covered inter-dealer security-based swaps subject to the exception engaged in over the course of the immediately preceding twelve months.<sup>150</sup>

<sup>145</sup> See Exchange Act Rule 3a71-2(a)(1).

<sup>146</sup> See Exchange Act Rule 3a71-3(b)(1)(iii)(C).

<sup>147</sup> See Exchange Act Rule 3a71-3(d).

<sup>148</sup> See Exchange Act Rule 3a71-3(d)(6)(ii)(A).

<sup>149</sup> See Exchange Act Rule 3a71-3(d)(6)(ii)(B).

<sup>150</sup> See Exchange Act Rule 3a71-3(d)(6)(ii)(B).

The relying entity would begin to count such positions against the *de minimis* thresholds on the date that the \$50 billion limit is breached. The final rule does not require the relying entity to recalculate its *de minimis* thresholds as of the dates

Finally, under the Commission's existing rules governing the *de minimis* threshold, a person who can no longer take advantage of the *de minimis* exception is not subject to regulation as a security-based swap dealer for a transitional period of either two months after the end of the month in which the person becomes unable to rely on the *de minimis* exception or until the person submits a complete application for registration as a security-based swap dealer, if earlier.<sup>151</sup> These rules also have two important consequences for entities who rely on the exception. First, a relying entity that breaches the \$50 billion limit and as a result also breaches a *de minimis* threshold need not seek to rely on the exception for transactions connected with dealing activity that occurs during this transitional period.<sup>152</sup> Second, Rule 3a71-3(d)(6)(i)(B) does not require a relying entity to count against the \$50 billion limit the transactions of any affiliate that is deemed not to be a security-based swap dealer pursuant to Rule 3a71-2(b).<sup>153</sup> As a result, a relying entity need not count against the \$50 billion limit the transactions of an affiliate that is in the process of registering as a security-based swap dealer.

#### (d) Impact of the Limitation on Reporting and Public Dissemination

As discussed in the statement regarding compliance with rules for security-based swap data repositories and Regulation SBSR in Part X.C below, all transactions connected with a relying entity's dealing activity that are arranged, negotiated, or executed by

the dealing activity connected with such newly included positions occurred. Requiring such a recalculation could cause a relying entity that breaches the \$50 billion limit to determine that it breached a *de minimis* threshold on an earlier date and, as a result, to find itself out of compliance with the registration deadline in Rule 3a71-2(b). The Commission believes that imposing such a result could make the exception unworkable for market participants and, accordingly, is adopting a requirement for the relying entity to count such positions against the *de minimis* thresholds beginning on the date that the \$50 billion limit is breached. However, counting such positions as of the date that the \$50 billion limit is breached does not require the relying entity to attribute that date to the dealing activity connected to such positions. Rather, the relying entity would count such positions using the respective dates of the dealing activity connected to such positions and, accordingly, would count against the *de minimis* thresholds any such positions connected with dealing activity engaged in over the course of the immediately preceding twelve months.

<sup>151</sup> See Exchange Act Rule 3a71-2(b), 17 CFR 240.3a71-2(b).

<sup>152</sup> Further, a relying entity that breaches the \$50 billion limit is not eligible to rely on the exception for additional transactions. See Exchange Act Rule 3a71-3(d)(1)(vii), (6)(ii)(A).

<sup>153</sup> See Exchange Act Rule 3a71-3(d)(6)(i)(B).

U.S. personnel in reliance on the exception will be required to be reported to a security-based swap data repository, and covered inter-dealer security-based swap transactions that at least one side of the transactions arranges, negotiates, or executes in reliance on the exception must also be publicly disseminated.

#### 2. Compliance With Specific Security-Based Swap Dealer Requirements

##### (a) Proposed Approach

Both alternatives to the proposed exception were conditioned in part on the registered entity complying with certain security-based swap dealer requirements as if the counterparties to the non-U.S. person relying on the exception also were counterparties to the registered entity. Those "as if" requirements addressed: (1) Disclosure of risks, characteristics, material incentives and conflicts of interest (regarding the registered entity, as well as material incentives and conflicts of interest associated with the non-U.S. person relying on the exception) (the "disclosure condition"); (2) suitability of recommendations (the "suitability condition"); (3) fair and balanced communications (the "communications condition"); (4) trade acknowledgment and verification (the "trade acknowledgment and verification condition"); and (5) certain portfolio reconciliation requirements (the "portfolio reconciliation condition").<sup>154</sup>

Those proposed conditions reflected the fact that the registered entity that would engage in arranging, negotiating, or executing activity in the United States in connection with the transactions at issue would not be a contractual party to the security-based swaps resulting from that activity. Absent those conditions, the registered entity accordingly would not necessarily trigger certain requirements

<sup>154</sup> See Alternatives 1 and 2—proposed Exchange Act Rule 3a71-3(d)(1)(ii)(A), (B). For Alternative 2, proposed paragraph (d)(1)(ii)(A) further would provide that the registered entity must comply with those requirements as if it also is registered as a security-based swap dealer, if it is not registered as a security-based swap dealer.

Those "as if" compliance conditions address the following security-based swap dealer requirements: (1) Exchange Act Section 15F(h)(3)(B)(i), (ii) and Exchange Act Rule 15Fh-3(b) provisions related to the disclosure of risks, characteristics, incentives and conflicts, and further specified that it would include material incentives and conflicts of interest associated with the non-U.S. person relying on the exception; (2) Rule 15Fh-3(f) suitability provisions; (3) Section 15F(h)(3)(C) and Rule 15Fh-3(g) fair and balanced communications provisions; (4) Rule 15Fi-1 and 15Fi-2 trade acknowledgment and verification provisions; and (5) proposed Rule 15Fi-3 portfolio reconciliation provisions, but only with respect to the initial reconciliation of the security-based swap resulting from the transaction.

that are predicated on being a "counterparty" to the transaction.<sup>155</sup> The Commission preliminarily concluded that the compliance burdens associated with those conditions would be justified by associated counterparty protections, or by risk-related benefits or other benefits.<sup>156</sup>

Conversely, the proposal specified that the registered entity would not have to comply with "counterparty"-related requirements that address: (1) Eligible counterparty ("ECP") verification; (2) daily mark disclosure; (3) clearing rights disclosure; (4) "know your counterparty" checks; (5) portfolio compression; and (6) trading relationship documentation.<sup>157</sup> For certain of those requirements the Commission reasoned that it would be difficult for the registered entity to obtain requisite information, while for others the Commission concluded that the requirements would be inapposite given the nature of the registered entity's activities in connection with the transaction.<sup>158</sup>

The proposal also recognized that the registered entity would be subject to certain additional requirements by virtue of its registered status. For Alternative 1, the Commission noted that the entity would have to comply with additional requirements applicable to registered security-based swap dealers, including requirements related to supervision, chief compliance officers, books and records, and financial responsibility.<sup>159</sup> For Alternative 2, the Commission noted that a registered broker would have to comply with applicable broker-dealer requirements under the federal security laws and self-regulatory organization ("SRO") rules.<sup>160</sup>

##### (b) Commission Action

The Commission continues to believe that the investor protection benefits of these conditions justify any burdens related to compliance with the conditions and is adopting the disclosure condition and trade acknowledgment and verification condition with additional guidance and the communications condition as proposed. The Commission is adopting the suitability condition with one modification and is not adopting the portfolio reconciliation condition. Accordingly, the exception is available only if the registered entity engaging in

<sup>155</sup> See Proposing Release, 84 FR at 24221.

<sup>156</sup> See *id.* at 24221-22.

<sup>157</sup> See Alternatives 1 and 2—proposed Exchange Act Rule 3a71-3(d)(1)(ii)(C).

<sup>158</sup> See Proposing Release, 84 FR at 24221.

<sup>159</sup> See *id.* at 24223.

<sup>160</sup> See *id.* at 24227.



the arranging, negotiating, or executing activity in the United States complies with certain disclosure, communications, trade acknowledgment and verification, and suitability requirements as if the counterparties to the non-U.S. person relying on the exception also were counterparties to the registered entity and, if the registered entity is a broker not registered as a security-based swap dealer, also as if it were a registered security-based swap dealer.<sup>161</sup> The discussion below considers each of these conditions in turn, as well as the interaction of the exception with substituted compliance and other requirements not applicable to the exception.

#### (1) Disclosure Condition

Disclosure of material information concerning the security-based swap in a manner reasonably designed to allow the counterparty to assess the material risks and characteristics of the security-based swap, as well as any material incentives or conflicts of interest the registered entity or the non-U.S. entity relying on the exception may have in connection with the security-based swap, will permit a counterparty to assess more effectively whether and under which terms to enter into a security-based swap transaction. The Commission does not agree with the commenter's suggestion that disclosures of material incentives and conflicts of interest should be limited to those of the registered entity but not of the non-U.S. entity relying on the exception.<sup>162</sup> A disclosure of material incentives and conflicts of interest would be meaningfully incomplete if it omitted those of the non-U.S. entity relying on the exception, because the relying entity is the counterparty to the transaction. As the Commission noted in the Proposing Release, though the compliance burdens associated with the disclosure condition "may be significant, those burdens should be mitigated by the underlying provision stating that the [disclosure] requirement . . . will apply only when the registered security-based swap dealer knows the identity of the counterparty at a reasonably sufficient time prior to

execution of the transaction."<sup>163</sup> The disclosure condition also requires disclosure of only material risks, characteristics, incentives, and conflicts of interest, and not disclosure of all risks, characteristics, incentives, and conflicts of interest.<sup>164</sup> Another commenter expressed the general view that the "as if" conditions "are duplicative and may lead to the imposition of undue costs without commensurate regulatory benefits."<sup>165</sup> To avoid the potential for duplicative disclosures, registered entities may choose to delegate to the relying entity the tasks of delivering the required disclosures and creating (but not maintaining) books and records relating to those disclosures as required by Rule 3a71-3(d)(1)(iii)(B)(1). A registered entity that delegates these tasks to the relying entity would remain responsible for ensuring that all of the disclosures required by Rule 3a71-3(d)(ii)(B)(1) are delivered in the manner described in Rule 15Fh-3(b), for ensuring that books and records relating to these disclosures are created as required by Rule 3a71-3(d)(1)(iii)(B)(1), and for itself maintaining books and records relating to these disclosures as required by Rule 3a71-3(d)(1)(iii)(B)(1).<sup>166</sup>

#### (2) Communications Condition

Similarly, the Commission concludes that the requirement for the registered entity to communicate with counterparties in a fair and balanced manner also will promote investor protection by prohibiting registered entities from overstating the benefits or understating the risks of potential transactions to inappropriately influence counterparties' investment decisions. One commenter expressly supported the proposed

communications condition.<sup>167</sup> In adopting the communications condition, the Commission is applying the same requirement<sup>168</sup> to the arranging, negotiating, or executing activity that the registered entity's U.S. personnel undertakes in connection with transactions not subject to the exception, thus minimizing any compliance burdens.

#### (3) Trade Acknowledgment and Verification Condition

The Commission believes that the trade acknowledgment and verification condition will help to ensure that there are definitive written records of the terms of the transactions that result from the registered entity's arranging, negotiating, or executing activity in the United States, as well as help to control legal and operational risks for the counterparties.<sup>169</sup> One commenter expressed the general view that the "as if" conditions "are duplicative and may lead to the imposition of undue costs without commensurate regulatory benefits."<sup>170</sup> To avoid the potential for duplicative trade acknowledgments and verifications, registered entities may choose to delegate to the relying entity the tasks of delivering the required trade acknowledgment or verification and creating (but not maintaining) books and records relating to that trade acknowledgment or verification as required by Rule 3a71-3(d)(1)(iii)(B)(1). A registered entity that delegates these tasks to the relying entity would remain responsible for ensuring compliance with the requirements of Rules 15Fi-1 and 15Fi-2 as required by Rule 3a71-3(d)(ii)(B)(4), for ensuring that books and records relating to the trade acknowledgment or verification are created as required by Rule 3a71-3(d)(1)(iii)(B)(1), and for itself maintaining books and records relating to the trade acknowledgment or verification as required by Rule 3a71-3(d)(1)(iii)(B)(1).

One commenter requested an exemption from Exchange Act Rule 10b-10 for brokers that may serve as the registered entity for purposes of the

<sup>163</sup> See Proposing Release, 84 FR at 24221 (citing Exchange Act Rule 15Fh-3(b)). As also noted in the Proposing Release, circumstances in which the registered entity engaged in activity pursuant to the exception may not know the identity of the counterparty could include circumstances in which the registered entity provides only execution services, and does not arrange or negotiate the transaction, as well as circumstances where U.S. personnel specify a trading strategy or techniques carried out through algorithmic trading or automated electronic execution of security-based swaps. See Proposing Release, 84 FR at 24224 n.149.

<sup>164</sup> See Exchange Act Rule 3a71-3(d)(1)(ii)(B)(1) (referencing Exchange Act Section 15F(h)(3)(B)(i)-(ii) and Rule 15Fh-3(b)).

<sup>165</sup> See ISDA letter at 9-10.

<sup>166</sup> For the avoidance of doubt, whether or not the registered entity delegates this task to the relying entity, the disclosures of material incentives and conflicts of interest generally should make clear which material incentives and conflicts of interest apply to the registered entity and which apply to the relying entity.

<sup>167</sup> See IIB/SIFMA letter at 13-14. That comment also expressed support for two features of the proposed framework that are not "as if" conditions—the application of anti-fraud provisions to the transactions at issue, and restrictions on transactions with non-ECPs. See *id.* at 12.

<sup>168</sup> See Exchange Act Rule 3a71-3(d)(1)(ii)(B)(3) (referencing Exchange Act Section 15F(h)(3)(C) and Rule 15Fh-3(g)); FINRA Rule 2210.

<sup>169</sup> See Proposing Release, 84 FR at 24222 (citing Trade Acknowledgment and Verification of Security-Based Swap Transactions, Exchange Act Release No. 78011 (June 8, 2016), 81 FR 39808 (June 17, 2016) ("Trade Acknowledgment and Verification Adopting Release").

<sup>170</sup> See ISDA letter at 9-10.

<sup>161</sup> See Exchange Act Rule 3a71-3(d)(1)(ii)(A). Following the adoption of the compliance date for SBS Entity registration described in Part XI.B, *infra*, staff understands that FINRA may review the application of its rules to security-based swap transactions and to SBS Entities who also are members of FINRA.

<sup>162</sup> See IIB/SIFMA letter at 8. The HSBC letter supported the recommendations of the IIB/SIFMA letter related to the proposed exception.

exception.<sup>171</sup> As an initial matter, the Commission notes that Rule 10b-10 may not apply to every instance in which a broker serves as the registered entity for purposes of the exception, as Rule 10b-10 applies to “transactions” that involve “customers.”<sup>172</sup> For activity to which both the Rule 3a71-3(d)(1)(ii)(B)(4) trade acknowledgment and verification condition and Rule 10b-10 may apply, however, the Commission believes that duplicative requirements should be avoided. In adopting Rules 15Fi-1 and 15Fi-2, the SBS Entity trade acknowledgment and verification rules upon which the trade acknowledgment and verification condition is based, the Commission noted that an SBS Entity that is also a broker or dealer could be required to comply with both Rule 10b-10 and Rule 15Fi-2.<sup>173</sup> The Commission believed that these duplicative requirements could be overly burdensome and concluded that an exemption from Rule 10b-10 was appropriate to avoid such a result, and therefore included such an exemption in the rule.<sup>174</sup> However, the Commission also limited the exemption from Rule 10b-10 to principal transactions; Rule 10b-10 continues to apply to security-based swap brokerage transactions.<sup>175</sup>

The Commission believes that the potential application of both Rule 10b-10 and the trade acknowledgment and verification condition could result in partially duplicative disclosures, but also notes that some of the disclosures required by Rule 10b-10 may not be duplicated in the trade acknowledgment and verification condition.<sup>176</sup> If the “arranging, negotiating, or executing” activity triggers Rule 10b-10, these additional disclosures required by Rule

10b-10 provide the customer with important information regarding the brokerage activity.<sup>177</sup> The Commission thus is adopting an exemption<sup>178</sup> from Rule 10b-10 with respect to any “arranging, negotiating, or executing” activity conducted in accordance with the exception. To qualify for the exemption, the broker must comply with the trade acknowledgment and verification condition in connection with activity that is subject to the exception, and include any applicable disclosures required by Rule 10b-10(a)(2) (excluding Rule 10b-10(a)(2)(i)-(ii)) and Rule 10b-10(a)(8) either in the trade acknowledgment or verification or in another disclosure<sup>179</sup> delivered to the counterparty. To avoid the potential for duplicative disclosures, registered entities may choose to delegate to the relying entity the tasks of delivering these Rule 10b-10 disclosures and creating (but not maintaining) books and records relating to those disclosures as required by Rule 3a71-3(d)(1)(iii)(B)(1).

Similarly, the trade acknowledgment and verification condition would require a trade acknowledgment to be delivered to the counterparty promptly, but in any event by the end of the first business day following the day of execution of the security-based swap transaction,<sup>180</sup> while Rule 10b-10 requires a confirmation to be delivered at or before completion of the transaction.<sup>181</sup> The Commission recognizes that imposing two competing timing standards for similar types of disclosures could unnecessarily increase compliance burdens, and believes that the time and form standards required by the trade acknowledgment and verification condition adequately protect counterparties to security-based swap transactions subject to the exception because they are the same standards that apply to registered security-based swap dealers.<sup>182</sup>

<sup>177</sup> For example, customers may use disclosures regarding the capacity in which the broker is acting and membership in the Securities Investor Protection Corporation to determine whether the broker is able to meet the customer's needs.

<sup>178</sup> See Exchange Act Rule 3a71-3(d)(5).

<sup>179</sup> For example, the Rule 10b-10 disclosures could be provided as part of the disclosures required pursuant to the disclosure condition in Rule 3a71-3(d)(1)(ii)(B)(1) discussed above.

<sup>180</sup> See Exchange Act Rule 15Fi-2(b), 17 CFR 240.15Fi-2(b).

<sup>181</sup> See Exchange Act Rule 10b-10(a), 17 CFR 240.10b-10(a).

<sup>182</sup> If the broker or dealer relying on this exemption from Rule 10b-10 makes a good faith effort to comply with the requirement to deliver these disclosures to the customer as and when required, the failure to do so will not make the exemption from Rule 10b-10 unavailable so long as the broker or dealer delivers the disclosures to the

#### (4) Suitability Condition

As proposed, the suitability condition would have required that if, as part of the registered entity's arranging, negotiating, or executing activity in the United States, the registered entity recommends a security-based swap or trading strategy involving a security-based swap to a counterparty of the non-U.S. entity relying on the exception, the registered entity must comply with the suitability requirements of Rule 15Fh-3(f)(1) as if the counterparty to the relying entity was its own counterparty. Accordingly, the registered entity would have to (1) undertake reasonable diligence to understand the potential risks and rewards associated with the recommended security-based swap or trading strategy involving a security-based swap (the “objective prong”) and (2) have a reasonable basis to believe that a recommended security-based swap or trading strategy involving a security-based swap is suitable for the counterparty (the “counterparty-specific prong”).<sup>183</sup> To satisfy the counterparty-specific prong as proposed, a security-based swap dealer would have to obtain relevant information regarding the counterparty, including the counterparty's investment profile, trading objectives, and its ability to absorb potential losses associated with the recommended security-based swap or trading strategy involving a security-based swap.<sup>184</sup>

The Commission is adopting the suitability condition with a modification that provides an alternative means of satisfying the counterparty-specific prong. Consistent with the condition as proposed, the suitability condition will apply to the exception only when the registered entity makes a recommendation to the counterparty.<sup>185</sup> Also consistent with the condition as proposed, the registered entity could choose to satisfy the counterparty-specific prong of the suitability condition by ensuring that it has a reasonable basis to believe that the recommended security-based swap or trading strategy involving a security-based swap is suitable for the counterparty, as required by Rule 15Fh-3(f)(1)(ii).<sup>186</sup>

The proposed rule provided an alternative means of satisfying the counterparty-specific prong for

customer promptly after discovery of the defect in compliance. See Exchange Act Rule 3a71-3(d)(5).

<sup>183</sup> See Exchange Act Rule 3a71-3(d)(1)(ii)(B)(2); see also Exchange Act Rule 15Fh-3(f)(1), 17 CFR 240.15Fh-3(f)(1).

<sup>184</sup> See Exchange Act Rule 15Fh-3(f)(1), 17 CFR 240.15Fh-3(f)(1).

<sup>185</sup> See *id.*

<sup>186</sup> See Exchange Act Rule 3a71-3(d)(1)(ii)(B)(2) (referencing Exchange Act Rule 15Fh-3(f)).

<sup>171</sup> See IIB/SIFMA letter at 13-14.

<sup>172</sup> See Exchange Act Rule 10b-10(a), 17 CFR 240.10b-10(a) (prohibiting a broker or dealer to effect for or with an account of a customer any transaction in, or to induce the purchase or sale by such customer of, a security unless the broker or dealer delivers a written confirmation at or before completion of the transaction).

<sup>173</sup> See Trade Acknowledgment and Verification Adopting Release, 81 FR at 39824.

<sup>174</sup> See *id.*

<sup>175</sup> See *id.* at 39824-25.

<sup>176</sup> While Rule 15Fi-2 requires a trade acknowledgment to disclose all terms of the security-based swap transaction, see Exchange Act Rule 15Fi-2(c), 17 CFR 240.15Fi-2(c), Rule 10b-10 includes provisions requiring disclosures that may not form part of the terms of the security-based swap transaction between the relying entity and its counterparty, including the capacity in which the broker (who would not be party to the transaction) is acting, see Exchange Act Rule 10b-10(a)(2), 17 CFR 240.10b-10(a)(2), and the fact that the broker is not a member of the Securities Investor Protection Corporation, if such is the case, see Exchange Act Rule 10b-10(a)(8), 17 CFR 240.10b-10(a)(8).

institutional counterparties. This alternative means contained four main elements. First, as proposed, the alternative means would have required the registered entity to reasonably determine that the institutional counterparty, or an agent to which the counterparty has delegated decision-making authority, is capable of independently evaluating investment risks with regard to the relevant security-based swap or trading strategy involving a security-based swap.<sup>187</sup> The proposed rule would have allowed the registered entity to satisfy this requirement by obtaining certain written representations.<sup>188</sup> Second, as proposed, the alternative means would have required the registered entity to obtain from the institutional counterparty or its agent affirmative written representations that it is exercising independent judgment in evaluating the recommendations with regard to the security-based swap or trading strategy involving a security-based swap.<sup>189</sup> Third, as proposed, the alternative means would have required the registered entity to disclose that it is acting in its capacity as a counterparty, and is not undertaking to assess the suitability of the security-based swap or trading strategy involving a security-based swap.<sup>190</sup> Fourth, as proposed, the alternative means would have been available only when the counterparty in fact is an institutional counterparty.

The Commission believes that the counterparty-specific prong's investor protection benefit for institutional counterparties is unlikely to justify the burden on both the registered entity and the institutional counterparty to obtain from the counterparty the information and representations as described above, solely to make a recommendation in connection with "arranging, negotiating, or executing" activity eligible for the exception. The Commission further believes it appropriate to eliminate from the alternative means of satisfying the counterparty-specific prong the proposed disclosure to the institutional counterparty that the registered entity is acting in its capacity as a counterparty, as the registered entity would not be acting as counterparty in connection with the "arranging, negotiating, or executing" activity subject to the exception. For these reasons, in adopting Rule 3a71-3(d)(1)(ii)(B)(2), the Commission has tailored the suitability

condition to allow the registered entity to comply with the counterparty-specific prong by reasonably determining that the counterparty to whom it makes a recommendation is an "institutional counterparty" as defined in Rule 15Fh-3(f)(4) and by disclosing to the counterparty that it is not undertaking to assess the suitability of the security-based swap or trading strategy involving a security-based swap for the counterparty.<sup>191</sup>

By allowing the counterparty-specific prong of the suitability condition to be satisfied by this disclosure when the registered entity makes a recommendation to a counterparty it reasonably determines is an institutional counterparty, the Commission also is partially addressing one commenter's suggestion to reduce both prongs of the suitability condition to a disclaimer when the registered entity does not have primary client responsibility for the counterparty.<sup>192</sup> This commenter expressed the view that the proposed suitability condition should be limited when the registered entity "is not assigned primary client responsibility for a non-U.S. counterparty," so that the registered entity merely would have to disclose that it is acting in its capacity as agent of the non-U.S. person relying on the exception, and that neither entity "is undertaking to assess the suitability of the SBS transaction or trading strategy."<sup>193</sup> The suitability condition would allow a disclaimer of the counterparty-specific prong, but not of the objective prong, when the registered entity reasonably determines that the counterparty is an institutional counterparty. The Commission does not agree with the commenter, however, that this alternative method of compliance should be available whenever the registered entity does not have primary client responsibility for the counterparty, or that the registered entity should be able to disclaim responsibility for understanding the potential risks and rewards of a particular product or strategy. Registered entities become involved in arranging, negotiating, or executing activity on behalf of a non-U.S. entity precisely because they are expected to have specialized knowledge and expertise regarding a particular security-based swap product or strategy, so the registered entity likely already possesses

the information needed to comply with the objective prong of the suitability condition. Moreover, when these registered entities make a recommendation regarding such a product or strategy, counterparties are likely to expect that the recommendation is based on reasonable diligence to understand its potential risks and rewards, as, again, the registered entity's specialized knowledge and expertise are likely the reason it becomes involved in arranging, negotiating, or executing activity on behalf of its non-U.S. affiliate. Further, the limitations suggested by the commenter would allow the registered entity to make recommendations to a counterparty that the registered entity does not reasonably believe to be an institutional counterparty without ensuring that the recommendation is suitable for the counterparty. The Commission recognizes that the counterparty-specific prong of the suitability condition may entail significant compliance burdens in some instances in which the registered entity must obtain the counterparty information and make a suitability assessment using that information.<sup>194</sup> However, the Commission continues to believe those burdens, now tailored to apply in full only when the registered entity does not reasonably determine that the counterparty is an institutional counterparty, are justified by the importance of the counterparty protections provided by this requirement.

#### (5) Proposed Portfolio Reconciliation Condition

The Commission is not adopting the proposed portfolio reconciliation condition. Two commenters called for the removal of the proposed portfolio reconciliation condition.<sup>195</sup> The

<sup>194</sup> As noted in the Proposing Release, however, the Commission understands that in some cases U.S. personnel currently manage trading or sales relationships with counterparties and thus already may possess the information needed to comply with the counterparty-specific prong of the suitability condition. See Proposing Release, 84 FR at 24222.

<sup>195</sup> See ISDA letter at 8 (stating that the portfolio reconciliation condition is "particularly problematic" in that it would add a two-way documentation burden "that would require extensive client-outreach and client responses within a short period of time"); IIB/SIFMA letter at 14 (stating that the condition likely would discourage non-U.S. counterparties from having interactions with U.S. personnel that could trigger the condition, and because the reconciliation process would be burdensome by encompassing non-economic terms of security-based swap transactions; arguing in the alternative that the Commission should permit the registered entity to comply with the condition if the non-U.S. person relying on the exception "is subject to portfolio

Continued

<sup>187</sup> See proposed Exchange Act Rule 3a71-3(d)(1)(ii)(B)(2) (referencing Exchange Act Rule 15Fh-3(f)).

<sup>188</sup> See *id.*

<sup>189</sup> See *id.*

<sup>190</sup> See *id.*

<sup>191</sup> See Exchange Act Rule 3a71-3(d)(1)(ii)(B)(2).

<sup>192</sup> See IIB/SIFMA letter at 13.

<sup>193</sup> See IIB/SIFMA letter at 17 (also suggesting that the Commission work with FINRA "to adopt a parallel exemption" from a FINRA suitability rule).

Commission is persuaded by comments that the burdens of compliance with the proposed condition would not justify its benefits. In particular, one commenter stated that the costs of developing new systems to conduct portfolio reconciliation between the non-U.S. counterparty and the registered entity, together with the condition's requirement regarding agreement in writing on the terms of portfolio reconciliation, "would likely discourage non-U.S. counterparties from having the interactions with U.S. personnel that could trigger the condition."<sup>196</sup> The Commission agrees that, in the context of transactions eligible for the exception, the costs of these requirements likely would have this effect on some non-U.S. counterparties, particularly given that the proposed condition would have prompted these costs in service of only one portfolio reconciliation between the counterparty and the registered entity. For these reasons, the Commission is not including the limited portfolio reconciliation requirement as a condition to the exception.

#### (6) Interaction of the Exception With Substituted Compliance

The Commission is not modifying the four adopted as-if conditions (disclosure condition, communications condition, trade acknowledgment and verification condition, and suitability condition) to allow them to be satisfied by substituted compliance or otherwise by compliance with the home-country requirements of the entity relying on the exception. One commenter argued that the Commission should generally allow for the use of substituted compliance in connection with those (and other) conditions.<sup>197</sup> Another commenter argued that the proposed trade acknowledgment and verification condition should be satisfied if the non-U.S. person relying on the exception "provides written documentation of the SBS's terms to the counterparty in compliance with [the non-U.S. person's] home country confirmation requirements."<sup>198</sup>

Any entity relying on the exception would be, by definition, a non-U.S. person not registered with the Commission. The relying entity thus

reconciliation requirements in its home jurisdiction").

<sup>196</sup> See IIB/SIFMA letter at 14.

<sup>197</sup> See ISDA letter at 9–10.

<sup>198</sup> See IIB/SIFMA letter at 13–14 (also suggesting that if the registered entity is a broker-dealer, the Commission and FINRA should exempt the entity from compliance with Rule 10b–10 and the FINRA fixed income confirmation rule if the non-U.S. person provides that documentation to the counterparty and discloses that the registered entity is acting as agent).

would not be eligible for substituted compliance, which is available only to registered SBS Entities, nor would it be covered by the "MOU or other arrangement addressing supervision and enforcement"<sup>199</sup> that is a key condition precedent of a substituted compliance determination. The registered entity also would not necessarily be able to ascertain whether or not the relying entity had complied with its home-country regulations to which the registered entity is not subject. Allowing the relying entity to satisfy the "as-if" conditions by way of compliance with its home-country requirements could compromise the Commission's ability to both supervise the registered entity and ascertain the relying entity's compliance with the "as-if" conditions. Instead, in applying the "as-if" conditions to the registered entity, the Commission is striking a balance that will allow flexibility for market participants engaging in cross-border security-based swap activity, but also further Title VII's goals of counterparty protection.<sup>200</sup>

#### (7) Requirements Not Applicable to the Exception

As proposed, the exception included a list of certain other "counterparty"-related requirements compliance with which would not be a condition to the availability of the exception. This proposed list included ECP verification requirements,<sup>201</sup> "know your counterparty" requirements,<sup>202</sup> clearing rights disclosure requirements,<sup>203</sup> daily mark disclosure requirements,<sup>204</sup> proposed portfolio compression requirements,<sup>205</sup> and proposed security-based swap trading relationship

<sup>199</sup> See Exchange Act Rule 3a71–6(a)(2)(ii), 17 CFR 3a71–6(a)(2)(ii).

<sup>200</sup> The Commission is mindful that the foreign blocking laws, privacy laws, secrecy laws, and other foreign legal barriers may limit or prohibit firms from providing books and records directly to the Commission. Similarly, such laws may impede the transfer of relevant records among affiliates for the purposes of complying with the exception. The exception is not available in situations in which such impediments to transferring information preclude compliance with conditions that require the relying entity to transfer information to the registered entity: The disclosure condition, the trade acknowledgment and verification condition, and conditions requiring the registered entity to obtain from the relying entity certain books and records. See also Proposing Release, 84 FR at 24222 n.126 & 24223–24 n.143.

<sup>201</sup> See Alternatives 1 and 2—proposed Exchange Act Rule 3a71–3(d)(1)(ii)(C)(1).

<sup>202</sup> See Alternatives 1 and 2—proposed Exchange Act Rule 3a71–3(d)(1)(ii)(C)(4).

<sup>203</sup> See Alternatives 1 and 2—proposed Exchange Act Rule 3a71–3(d)(1)(ii)(C)(3).

<sup>204</sup> See Alternatives 1 and 2—proposed Exchange Act Rule 3a71–3(d)(1)(ii)(C)(2).

<sup>205</sup> See Alternatives 1 and 2—proposed Exchange Act Rule 3a71–3(d)(1)(ii)(C)(5).

documentation requirements.<sup>206</sup> One commenter argued that the exception should not be subject to compliance with these requirements,<sup>207</sup> and the Commission agrees. In the case of the ECP verification requirements and "know your counterparty" requirements, the Commission continues to believe that in some circumstances the registered entity would have limited interaction with the counterparty to the transactions subject to the exception, making it difficult to obtain the information needed to satisfy those requirements. Nevertheless, existing limitations on entering into security-based swaps with non-ECPs will remain in effect.<sup>208</sup> Similarly, the Commission agrees that the exception should not be conditioned on compliance with clearing rights disclosure requirements because the transactions subject to the exception would not be expected to be subject to the underlying clearing rights as such rights apply only to transactions "entered into" by security-based swap dealers.<sup>209</sup> The Commission also continues to believe that the exception should not be conditioned on compliance with daily mark disclosure requirements because those requirements are predicated on there being an ongoing relationship between the registered entity and the counterparty that may not be present in connection with the transactions subject to the exception, and further would be linked to risk management functions that are likely to be associated with the entity in which the resulting security-based swap position is booked. Finally, the Commission is considering in a separate release final rules regarding portfolio compression and trading relationship documentation, and continues to believe that the exception should not be conditioned on compliance with those rules.

Although the Commission agrees that a party complying with the exception should not be required to comply with these requirements, the Commission believes that including a list of these requirements in Rule 3a71–3 could potentially cause confusion among

<sup>206</sup> See Alternatives 1 and 2—proposed Exchange Act Rule 3a71–3(d)(1)(ii)(C)(6).

<sup>207</sup> See IIB/SIFMA letter at 12.

<sup>208</sup> See Exchange Act Section 6(l), 15 U.S.C. 78f(l) (requiring security-based swaps with non-ECPs to be effected on a national securities exchange); Securities Act of 1933 Section 5(e), 15 U.S.C. 77e(e) (requiring registration of the offer and sale of security-based swaps to non-ECPs). The registered entity might use information obtained from its non-U.S. affiliate to verify that a counterparty to the security-based swap is in fact an ECP.

<sup>209</sup> See Exchange Act Section 3C(g)(5), 15 U.S.C. 78c–3(g)(5).

market participants. As proposed, this list of requirements was described as a list of Exchange Act provisions and rules and regulations thereunder to which the “compliance obligation described in paragraph (d)(1)(ii)(A) [of Rule 3a71–3] does not apply.”<sup>210</sup> However, paragraph (d)(1)(ii)(A) of Rule 3a71–3 states only that, in connection with transactions subject to the exception, the registered entity must “comply with the requirements described in paragraph (d)(1)(ii)(B) [of Rule 3a71–3] as if the counterparties to the non-U.S. person relying on this exception also were counterparties to the registered entity.”<sup>211</sup> Paragraph (d)(1)(ii)(B) of Rule 3a71–3, in turn, lists the requirements that together comprise the “as-if” conditions discussed above. The Commission therefore does not believe it is necessary to include in Rule 3a71–3 the proposed list of requirements with which the registered entity need not comply.

### 3. Commission Access to Relevant Books, Records and Testimony, and Related Obligations

#### (a) Proposed Approach

The proposal would require the non-U.S. person relying on the conditional exception, upon request, to promptly provide the Commission or its representatives with any information or documents within the non-U.S. person’s possession, custody or control related to transactions under the exception, to make its foreign associated persons<sup>212</sup> available for testimony, and to provide assistance in taking the evidence of other persons, wherever located, related to those transactions.<sup>213</sup>

<sup>210</sup> See Alternatives 1 and 2—proposed Exchange Act Rule 3a71–3(d)(1)(iii)(C).

<sup>211</sup> See Exchange Act Rule 3a71–3(d)(1)(ii)(A).

<sup>212</sup> Proposed paragraph (a)(11) of Rule 3a71–3 defined the term “foreign associated person” as a natural person domiciled outside the United States that is a partner, officer, director, or branch manager of the non-U.S. person relying on the exception (or any person occupying a similar status or performing similar functions); any employee of that non-U.S. person; or any person that directly or indirectly controls, is controlled by, or is under common control with that non-U.S. person.

<sup>213</sup> See Alternatives 1 and 2—proposed Exchange Act Rule 3a71–3(d)(1)(iii)(A). That proposed condition further would provide that if, despite the non-U.S. person’s best efforts, the non-U.S. person is prohibited by applicable foreign law or regulations from providing such access to the Commission, the non-U.S. person may continue to rely on the exception until the Commission issues an order modifying or withdrawing an associated “listed jurisdiction” determination. The proposed provisions relating to the “listed jurisdiction” condition to the exception in part would permit the Commission to withdraw a listed jurisdiction determination if the jurisdiction’s laws or regulations have had the effect of preventing the Commission or its representatives from accessing

The proposal further would require that the registered entity engaged in the arranging, negotiating or executing activity in the United States create and maintain all required books and records relating to the transactions at issue.<sup>214</sup> That registered entity further would be required to obtain, from the non-U.S. person relying on the exception, and maintain documentation encompassing all terms governing the trading relationship between the non-U.S. person and its counterparty relating to the transactions subject to the exception.<sup>215</sup> The registered entity also would have to obtain, from the non-U.S. person relying on the exception, written consent to service of process for any civil action brought by or proceeding before the Commission.<sup>216</sup>

Those proposed requirements were intended to “help provide the Commission with a comprehensive view of the dealing activities connected with transactions relying on the proposed exception, and facilitate the Commission’s ability to identify fraud and abuse in connection with transactions that have been arranged, negotiated, or executed in the United States.”<sup>217</sup>

#### (b) Commission Action

The Commission is adopting these books and records-related conditions, including the definition of “foreign associated person” with modifications.<sup>218</sup> As discussed in Part II.C.1 above, the Commission also is adopting a requirement for each registered entity whose associated persons may conduct “arranging, negotiating, or executing” activity pursuant to the exception to obtain from the relying entity, and maintain, documentation regarding the relying entity’s compliance with the \$50 billion limit on the availability of the exception.<sup>219</sup> Further, to ensure that registered entity is able to make relevant records available to the Commission as needed, and to provide greater certainty

such information, documents and testimony. See Part II.C.5, *infra*.

<sup>214</sup> See Alternatives 1 and 2—proposed Exchange Act Rule 3a71–3(d)(1)(iii)(B)(1).

<sup>215</sup> See Alternatives 1 and 2—proposed Exchange Act Rule 3a71–3(d)(1)(iii)(B)(2). These would include terms addressing payment obligations, netting of payments, events of default or other termination events, calculation and netting of obligations upon termination, transfer of rights and obligations, allocation of any applicable regulatory reporting obligations, governing law, valuation, and dispute resolution.

<sup>216</sup> See Alternatives 1 and 2—proposed Exchange Act Rule 3a71–3(d)(1)(iii)(B)(3).

<sup>217</sup> Proposing Release, 84 FR at 24224.

<sup>218</sup> See Exchange Act Rule 3a71–3(a)(13), (d)(1)(iii).

<sup>219</sup> See Exchange Act Rule 3a71–3(d)(1)(iii)(B)(2).

to market participants who conduct activity pursuant to the exception, the Commission also is adopting record retention requirements in new Rule 3a71–3(d)(1)(iii)(B)(2)–(4). One commenter expressed the view that the Commission’s access should be limited to the books and records of the registered entity, and should not extend to books and records of the non-U.S. person relying on the exception, because “the Commission’s regulatory nexus or interest in the transaction does not go beyond the ‘arranging’ or ‘negotiating’ activities conducted in the United States.”<sup>220</sup> The Commission’s ability to access books and records, and obtain relevant testimony, of the relying entity is key to the Commission’s ability to evaluate compliance with the exception. These conditions will help to provide the Commission with information about the dealing activities connected with transactions relying on the exception and will help to demonstrate whether the relying entity properly classified transactions as eligible for the exception. The conditions also will facilitate the Commission’s ability to enforce against fraud and abuse in connection with transactions subject to the exception that have been arranged, negotiated, or executed in the United States.<sup>221</sup>

### 4. Notices to Counterparties

#### (a) Proposed Approach

The proposed exception was conditioned on the registered entity notifying the counterparty of the non-U.S. person relying on the exception that the non-U.S. person is not registered as a security-based swap dealer, and that certain Exchange Act provisions or rules addressing the regulation of security-based swaps would not be applicable in connection with the transaction, including provisions affording clearing rights to counterparties (the “notification condition”).<sup>222</sup> The

<sup>220</sup> See ISDA letter at 9.

<sup>221</sup> As explained in the Proposing Release, and consistent with Exchange Act Rules 17a–3, 17a–4, 18a–5, and 18a–6, the registered entity would create, obtain and/or maintain the following types of records related to the “arranging, negotiating, or executing” activity subject to the exception: Records of communications; written agreements; copies of trade acknowledgments and verifications; records related to transactions not verified in a timely manner; and documents related to compliance with security-based swap dealer business conduct standards. Other types of records addressed in Rules 17a–3, 17a–4, 18a–5, and 18a–6—e.g., inclusion of trades in financial ledgers—would not appear to be required for the registered entity in connection with “arranging, negotiating, or executing” activity subject to the exception. See Proposing Release, 84 FR at 24223 n.141.

<sup>222</sup> See Proposing Release, 84 FR at 24224.

proposal required the registered entity to provide this information contemporaneously with and in the same manner as the arranging, negotiating, or executing activity that is the subject of the exception, and did not require the notice to be made if the registered entity does not know the identity of the counterparty at a reasonably sufficient time prior to the execution of the transaction.<sup>223</sup> The Commission intended this condition “to help guard against counterparties assuming that the involvement of U.S. personnel in an arranging, negotiating, or executing capacity as part of the transaction would be accompanied by all of the safeguards associated with Title VII security-based swap dealer regulation.”<sup>224</sup>

#### (b) Commission Action

The Commission is adopting the notification condition with a modification that provides an alternative means of satisfying the condition. Consistent with the proposal, the final rules require the registered entity to notify the counterparty that the entity relying on the exception is not registered as a security-based swap dealer and that certain Exchange Act provisions or rules do not apply to the transaction.<sup>225</sup> Like the proposal, this notification is not required when the registered entity does not know the counterparty’s identity at a reasonably sufficient time prior to the execution of the transaction to permit the notification.<sup>226</sup> Two commenters argued that, if the Commission adopts this condition, the registered entity should be able to make the required notice one time to cover the entire relationship with the counterparty; these commenters cited the difficulty of making and documenting the notice contemporaneously with every counterparty contact.<sup>227</sup> The Commission believes that a single notice given at the first arranging, negotiating, or executing activity that is subject to the exception is sufficient to cover all subsequent arranging, negotiating, or

executing activity of a registered entity that has no other customer or counterparty relationship with the counterparty. When the registered entity does have a separate customer or counterparty relationship with the counterparty, the need to identify transactions to which the full protection of the U.S. securities laws does not apply becomes more acute. In these situations, the Commission believes that a contemporaneous notice made in the same manner as the arranging, negotiating, or executing activity subject to the exception best fulfills the condition’s investor protection goals. Accordingly, the final rules provide that, during a period in which the counterparty is not a customer<sup>228</sup> of the registered entity or a counterparty to a security-based swap with the registered entity, the notice need only be provided contemporaneously with, and in the same manner as, the first arranging, negotiating, or executing activity with that counterparty, rather than with each such activity during the period in which the counterparty is not such a customer or counterparty. Because this single notice is permitted only during a period in which the counterparty is not a customer of the registered entity or a counterparty to a security-based swap with the registered entity, the final rules would require the registered entity to resume providing the notice contemporaneously with, and in the same manner as, each arranging, negotiating, or executing activity at issue if the counterparty later becomes a customer of the registered entity or a counterparty to a security-based swap with the registered entity. In adopting this change, the Commission is balancing commenters’ concerns regarding the practical challenges of repeating the notice contemporaneously with each arranging, negotiating, or executing activity subject to the exception with the need to avoid confusion among counterparties regarding the applicability of U.S. securities laws to transactions arranged, negotiated, or executed by personnel located in the United States.

### 5. Applicability of Financial Responsibility Requirements of a Listed Jurisdiction

#### (a) Proposed Approach

Finally, the proposed exception would be conditioned on the requirement that the non-U.S. person

relying on the exception be subject to the margin and capital requirements of a “listed jurisdiction” when engaging in the transactions at issue (the “listed jurisdiction condition”).<sup>229</sup> This condition was intended “to help avoid creating an incentive for dealers to book their transactions into entities that solely are subject to the regulation of jurisdictions that do not effectively require security-based swap dealers or comparable entities to meet certain financial responsibility standards.”<sup>230</sup> The Commission proposed corresponding amendments to Rule 0–13 to provide a mechanism for applications for designation as a listed jurisdiction.<sup>231</sup>

The proposal specified that the Commission conditionally or unconditionally may determine “listed jurisdictions” by order, in response to applications or upon the Commission’s own initiative.<sup>232</sup> In considering a jurisdiction’s potential status as a “listed jurisdiction,” the Commission would consider whether an order would be in the public interest, based on factors such as the jurisdiction’s applicable margin and capital requirements, and the effectiveness of the foreign regime’s supervisory compliance program and enforcement authority in connection with those

<sup>229</sup> See Alternatives 1 and 2—proposed Exchange Act Rule 3a71–3(d)(1)(v). Under the proposal, the term “listed jurisdiction” was defined to mean any jurisdiction which the Commission by order has designated as a listed jurisdiction for purposes of the exception. See proposed Exchange Act Rule 3a71–3(a)(12).

<sup>230</sup> See Proposing Release, 84 FR at 24225. The Commission further explained: Absent this type of condition, the exception from the *de minimis* counting requirement could provide a competitive advantage to non-U.S. persons that conduct security-based swap dealing activity in the United States without being subject to sufficient financial responsibility standards. More generally, the proposed condition is consistent with the belief the Commission expressed when it adopted the “arranged, negotiated, or executed” *de minimis* counting rule, that applying capital and margin requirements to such transactions between two non-U.S. persons can help mitigate the potential for financial contagion to spread to U.S. market participants and to the U.S. financial system more generally.*Id.*

<sup>231</sup> See Proposing Release, 84 FR at 24290–91.

<sup>232</sup> See Alternatives 1 and 2—proposed Exchange Act Rule 3a71–3(d)(2).

The proposal further provided that applications for a listed jurisdiction order may be made by a party or group of parties that potentially would seek to rely on the exception from the *de minimis* counting requirement, or by a foreign financial regulatory authority supervising such a party or its security-based swap activities. See Alternatives 1 and 2—proposed Exchange Act Rule 3a71–3(d)(2)(i). The rule also specified that applications must be filed pursuant to the procedures set forth in Exchange Act Rule 0–13 (which as adopted addresses substituted compliance applications), and the Commission proposed to amend Rule 0–13 to also address listed jurisdiction applications.

<sup>223</sup> See *id.*

<sup>224</sup> See *id.*

<sup>225</sup> See Exchange Act Rule 3a71–3(d)(1)(iv).

<sup>226</sup> See *id.* As noted in the Proposing Release, circumstances in which the registered entity engaged in activity pursuant to the exception may not know the identity of the counterparty could include circumstances in which the registered entity provides only execution services, and does not arrange or negotiate the transaction, as well as circumstances where U.S. personnel specify a trading strategy or techniques carried out through algorithmic trading or automated electronic execution of security-based swaps. See Proposing Release, 84 FR at 24224 n.149.

<sup>227</sup> See ISDA letter at 9; IIB/SIFMA letter at 14–15.

<sup>228</sup> The term “customer” is defined consistent with the definition of the term in Rule 15c3–3, the customer protection rule that applies to brokers and dealers. See Exchange Act Rule 15c3–3(a)(1), 17 CFR 240.15c3–3(a)(1).

requirements, including in the cross-border context.<sup>233</sup>

The proposal further specified that the Commission might modify<sup>234</sup> or withdraw a listed jurisdiction determination, after notice and opportunity for comment, if the Commission determines that continued listed jurisdiction status would not be in the public interest. That could be based on the above factors regarding the jurisdiction's margin and capital requirements and associated supervisory and enforcement practices, or it could be based on consideration of whether the jurisdiction's laws or regulations have had the effect of preventing the Commission or its representatives from promptly being able to obtain information regarding the non-U.S. persons relying on the exception.<sup>235</sup>

The Commission also addressed the distinction between "listed jurisdiction" determinations and determinations for substituted compliance, and clarified that listed jurisdiction status would not be predicated on the foreign jurisdiction's financial responsibility regime being comparable to Title VII requirements.<sup>236</sup>

In proposing the "listed jurisdiction" condition, the Commission recognized that commenters to the Commission's earlier proposal for the "arranged,

negotiated, or executed" counting requirement suggested that potential concerns regarding the outcome that the condition was intended to avoid could be addressed by conditioning a broker-dealer based alternative to the counting rule on the non-U.S. entity being regulated in a "local jurisdiction recognized by the Commission as comparable," or in a G-20 jurisdiction or in a jurisdiction where the entity would be subject to Basel capital requirements. The Commission stated, however, that it did not believe that those concerns would be addressed adequately by a "one size fits all" approach that was linked simply to a jurisdiction's membership in the G-20 or compliance with Basel standards, with no further opportunity to consider relevant regulatory practices and requirements.<sup>237</sup>

The proposal also preliminarily stated, based on the Commission's understanding of relevant margin and capital requirements, an initial set of listed jurisdictions and that the Commission might issue a set of listed jurisdiction orders in conjunction with its final action on the proposed exception.<sup>238</sup>

#### (b) Commission Action

The Commission is adopting the listed jurisdiction condition, together with the related amendments to Rule 0-13, as proposed.<sup>239</sup> The listed jurisdiction condition is intended to deter dealers from attempting to avoid Title VII by simply booking their transactions to entities in jurisdictions that do not effectively require security-based swap dealers or comparable entities to meet certain financial responsibility standards.<sup>240</sup> Without the requirement, the exception could "provide a competitive advantage to non-U.S. persons that conduct security-

based swap dealing activity in the United States without being subject to sufficient financial responsibility standards."<sup>241</sup> More generally, the condition is consistent with the view that applying capital and margin requirements to transactions between two non-U.S. persons that have been arranged, negotiated, or executed in the United States can help mitigate the potential for financial contagion to spread to U.S. market participants and to the U.S. financial system more generally.<sup>242</sup>

In making its determination as to whether a foreign jurisdiction warrants a "listed jurisdiction" designation, in addition to the other requirements of the exception, the Commission may consider "factors relevant for purposes of assessing whether such a designation would be in the public interest."<sup>243</sup> Two such factors included in the rule are the jurisdiction's applicable margin and capital requirements<sup>244</sup> and the effectiveness of the relevant foreign financial regulatory authority's supervisory compliance program and enforcement authority in connection with those requirements, including in the cross-border context.<sup>245</sup> As part of assessing whether a designation would be in the public interest, the Commission also expects to consider whether a foreign jurisdiction has a security-based swaps market that demonstrates both a potential need for designation as a listed jurisdiction and an incentive for the relevant foreign financial regulatory authorities to oversee that market. With these factors in mind, the Commission may not designate all G-20 jurisdictions as listed jurisdictions as one commenter

<sup>233</sup> See Alternatives 1 and 2—proposed Exchange Act Rule 3a71-3(d)(1)(ii).

<sup>234</sup> The proposal explained that the Commission may modify a listed jurisdiction determination when: (1) Certain market participants or classes of market participants in the jurisdiction are not required to comply with the relevant financial responsibility requirements; (2) the jurisdiction's supervisory or enforcement practices oversee certain market participants or classes of market participants differently than others; or (3) the jurisdiction's barriers to data access apply to certain market participants or classes of market participants but not others. The Commission further noted that, in practice, the use of this authority may cause the exception to be unavailable to certain groups of market participants in a jurisdiction, or to individual market participants. See Proposing Release, 84 FR at 24225-26.

<sup>235</sup> See Alternatives 1 and 2—proposed Exchange Act Rule 3a71-3(d)(1)(iii). As the Commission explained, those latter criteria reflected the importance of the proposed exception's information access condition, as well as the conclusion that it would be appropriate to modify or withdraw listed jurisdiction status if, in practice, the Commission or its representatives have been prevented from accessing information required under the exception due to the jurisdiction's laws or regulations. See Proposing Release, 84 FR at 24225.

<sup>236</sup> As the Commission explained, listed jurisdiction applications and substituted compliance applications would arise in distinct contexts, and "the different purposes of these proposed exclusions and a substituted compliance determination mean that the Commission may reach different conclusions regarding these issues when considering a substituted compliance determination than it does when considering listed status." See Proposing Release, 84 FR at 24226.

<sup>237</sup> See Proposing Release, 84 FR at 24225. The proposal further explained:

The Commission is mindful that a jurisdiction's membership in the G-20 or its compliance with Basel standards can be a positive indicator regarding the effectiveness of the jurisdiction's margin and capital regimes. At the same time, the Commission also recognizes that implementation and oversight practices may vary even among those jurisdictions. Accordingly, the Commission preliminarily believes that the proposed individualized "listed jurisdiction" assessment would provide us an appropriate degree of discretion to consider whether the jurisdiction has implemented appropriate financial responsibility standards and exercises appropriate supervision in connection with those standards, and whether the Commission as necessary could access relevant information.

*Id.*

<sup>238</sup> See Proposing Release, 84 FR at 24226.

<sup>239</sup> See Exchange Act Rule 3a71-3(d)(1)(v); Rule 0-13.

<sup>240</sup> See Proposing Release, 84 FR at 24225.

<sup>241</sup> *Id.*

<sup>242</sup> *Id.*

<sup>243</sup> Exchange Act Rule 3a71-3(d)(2)(ii).

<sup>244</sup> In assessing a jurisdiction's applicable margin and capital requirements, the Commission would expect to consider whether the margin and capital requirements at issue would apply to entities who transact in security-based swaps. For example, in a jurisdiction where heightened margin and capital requirements for OTC derivatives are only applicable to certain types of entities, such as banks, the Commission may limit a listed jurisdiction order to entities covered by such requirements.

<sup>245</sup> *Id.* The Commission does not consider impediments to information access as part of its initial listed jurisdiction determination. However, the Commission may modify or withdraw listed jurisdiction status in the event that, in practice, among other things, the Commission or its representatives have been prevented from accessing information due to the jurisdiction's laws and regulations. Exchange Act Rule 3a71-3(d)(2)(iii)(B). The Commission also may modify or withdraw listed jurisdiction status, if the Commission otherwise finds that continued listing jurisdiction status is no longer in the public interest based on any factor the Commission determines to be relevant. See Exchange Act Rule 3a71-3(d)(2)(iii).



suggested.<sup>246</sup> The implementation of margin and capital requirements, as well as supervision and enforcement of them, varies significantly across G–20 jurisdictions.<sup>247</sup> Moreover, many G–20 jurisdictions do not have substantial security-based swap markets and as such may not necessarily have comparable incentives or resources to oversee those markets. By separate order, taking into account the factors described above and the other requirements of new paragraph (d)(2) to Rule 3a71–3, the Commission has designated Australia, Canada, France, Germany, Japan, Singapore, Switzerland, and the United Kingdom as listed jurisdictions.

Finally, designation as a listed jurisdiction serves a purpose distinct from, and is subject to substantially different requirements than, those of a substituted compliance order. As noted above, designation as a listed jurisdiction helps to avoid a competitive advantage for non-U.S. persons that might otherwise conduct security-based swap dealing activity in the United States “without being subject to sufficient financial responsibility standards.”<sup>248</sup> Also as noted above, the Commission may consider whether designation as a listed jurisdiction is in the public interest in light of the relevant jurisdiction’s applicable margin and capital requirements, but these requirements need not be comparable to U.S. requirements.<sup>249</sup> Similarly, the Commission may consider, as a factor in determining listed jurisdiction status, the effectiveness of the relevant foreign financial regulatory authority’s supervisory compliance program and enforcement authority in connection with those requirements, including in the cross-border context, but this effectiveness need not require an MOU or other arrangement with the foreign financial regulatory authorities addressing supervisory and enforcement cooperation.<sup>250</sup> By contrast, a substituted compliance determination

in part requires<sup>251</sup> the Commission to assess the comparability of a foreign financial regulatory system to Exchange Act requirements<sup>252</sup> and to enter into a supervisory and enforcement memorandum of understanding and/or other arrangement with the relevant foreign financial regulatory authorities addressing supervisory and enforcement cooperation arising under the substituted compliance determination.<sup>253</sup> As a result, while a listed jurisdiction application may raise issues that are similar to those that would accompany applications for substituted compliance, the Commission expects to evaluate applications for designation as a listed jurisdiction independently of those regarding substituted compliance, and may reach different conclusions regarding a substituted compliance application than it does regarding a listed jurisdiction application.

One commenter criticized the proposed listed jurisdiction condition on the grounds that the proposal would not require the foreign regime to be comparable to U.S. regulation, and that the Commission’s consideration of financial responsibility criteria would be optional.<sup>254</sup> However, the Commission believes that, unlike in the context of substituted compliance, designation as a listed jurisdiction need not require comparability of capital and margin requirements to serve its intended purpose to deter non-U.S. entities relying on the exception from conducting dealing activity in the United States without being subject to sufficient financial responsibility standards. Further, the final rule does not require the Commission to consider applicable margin and capital requirements but, rather, lists these

requirements as a factor that the Commission may consider relevant for purposes of assessing whether a listed jurisdiction order would be in the public interest. In the Commission’s view, this flexibility in the rules is warranted because different regulatory systems may be able to further the goal of the listed jurisdiction condition through other financial responsibility measures. In assessing listed jurisdiction status, the Commission may need to take into account the manner in which the jurisdiction’s regulatory system is informed by local business and market practices. While recognizing the commenter’s desire to require an assessment of the jurisdiction’s applicable capital and margin requirements, in this circumstance the Commission believes that the listed jurisdiction assessments will turn upon relevant facts and circumstances in a manner such that it would not be practicable to impose such a requirement.

### III. Amendment to Rule 15Fb2–1 and Guidance on the Certification and Opinion of Counsel Requirements

#### A. General

Exchange Act Rule 15Fb2–4 requires that nonresident SBS Entities seeking to register with the Commission certify that they can, as a matter of law, and will provide the Commission with access to their books and records and submit to onsite examination. The rule also requires that nonresident SBS Entities submit with their Forms SBSE, SBSE–A, or SBSE–BD, as appropriate, an opinion of counsel determining that they can, as a matter of law, provide the Commission with access to their books and records and submit to onsite examination.

As discussed in the Proposing Release,<sup>255</sup> after the adoption of the registration rules for SBS Entities, the Commission staff received a number of questions regarding the scope of the certification and opinion of counsel requirement in Exchange Act Rule 15Fb2–4.<sup>256</sup> Some of the questions related to issues raised by foreign blocking laws, privacy laws, secrecy laws and other foreign legal barriers that may limit or prohibit firms from: (i) Providing books and records directly to

<sup>246</sup> See IIB/SIFMA letter at 15 (citing the G–20 jurisdictions’ “progress toward adopting capital and margin requirements consistent with international standards”; further stating that “the concentration of the SBS markets in the G20 jurisdictions limits the negative consequences” of the listed jurisdiction condition, and that “the swaps markets in emerging markets are significantly larger”). The same commenter also generally supported the listed jurisdiction condition. See *id.*

<sup>247</sup> See, e.g., Financial Stability Board, OTC Derivatives Market Reforms: Thirteenth Progress Report on Implementation (Oct. 15, 2019), available at <https://www.fsb.org/wp-content/uploads/P151019.pdf>.

<sup>248</sup> See Proposing Release, 84 FR at 24225.

<sup>249</sup> See Exchange Act Rule 3a71–3(d)(2)(ii).

<sup>250</sup> See *id.*

<sup>251</sup> See Exchange Act Rule 3a71–6(a)(2), 17 CFR 240.3a71–6(a)(2) (“The Commission shall not make a substituted compliance determination . . . unless the Commission [satisfies certain conditions].”)

<sup>252</sup> See Exchange Act Rule 3a71–6(a)(2)(i), 17 CFR 240.3a71–6(a)(2)(i).

<sup>253</sup> See Exchange Act Rule 3a71–6(a)(2)(ii), 17 CFR 240.3a71–6(a)(2)(ii).

<sup>254</sup> See AFR letter at 4 (“However, the Proposal is explicit that the Commission would not be required to find that the regulatory regime in a listed jurisdiction is comparable to U.S. regulation. Instead, designation as a listed jurisdiction is completely at the discretion of the Commission, which “may conditionally or unconditionally determine” which jurisdictions qualify based on a vague public interest standard. While a few criteria are set forward, such as the existence (but not the stringency) of capital and margin standards in the jurisdiction, and the effectiveness of the supervisory compliance program in the jurisdiction, Commission consideration of these factors is completely optional. Thus, by no means would regulation in a listed jurisdiction guarantee regulatory protections comparable to U.S. oversight under Title VII of Dodd-Frank.” (footnote omitted)).

<sup>255</sup> See Proposing Release, 84 FR at 24233–38.

<sup>256</sup> See, e.g., letter from Briget Polichene, Chief Executive Officer, Institute of International Bankers, and Kenneth E. Bentsen, President and CEO, SIFMA, dated August 26, 2016 (available at <https://www.sec.gov/comments/s7-05-14/s70514-18.pdf>), and email from Sarah A. Miller, Chief Executive Officer, Institute of International Bankers, dated November 16, 2016 (available at <https://www.sec.gov/comments/s7-05-14/s70514-19.pdf>).

the Commission; or (ii) submitting to an onsite inspection or examination by SEC staff.<sup>257</sup> In general, the firms requested guidance as to whether the certification and opinion of counsel could take into account different approaches available under foreign blocking laws, privacy laws, secrecy laws or other legal barriers that may facilitate firms' ability to provide books and records to the Commission and submit to an examination or inspection by Commission staff in a manner consistent with a particular foreign legal requirement.

#### 1. Proposed Approach

As indicated in the Proposing Release, the Commission recognizes that foreign blocking laws, privacy laws, secrecy laws or other legal barriers may vary in purpose and scope, among other aspects. In recognition of the differences among foreign laws, the Commission proposed guidance to firms seeking clarification as to the requirement, in Rule 15Fb2-4, that a non-resident SBS Entity applicant provide the Commission with a certification and opinion of counsel. In particular, and as discussed in more detail below, the Commission proposed guidance to Exchange Act Rule 15Fb2-4 regarding: (1) The foreign laws that must be covered by the certification and opinion of counsel; (2) the scope of the books and records that are the subject of the certification and opinion of counsel, namely that the certification and opinion of counsel need only address: (i) Records that relate to the "U.S. business" (as defined in Exchange Act Rule 3a71-3(a)(8)) of the nonresident SBS Entity; and (ii) financial records necessary for the Commission to assess the compliance of the nonresident SBS Entity with capital and margin requirements under the Exchange Act and rules promulgated by the Commission thereunder, if these capital and margin requirements apply to the nonresident SBS Entity; (3) predication of a firm's certification and opinion of counsel, as necessary, on the nonresident SBS Entity obtaining prior consent of the persons whose information is or will be included in the books and records to allow the firm to promptly provide the Commission with direct access to its books and records and to submit to on-site inspection and examination; (4) applicability of the certification and opinion of counsel to contracts entered into prior to the date

on which the SBS Entity submits an application for registration pursuant to Section 15F(b); and (5) whether the certification and opinion of counsel submitted by a nonresident SBS Entity can take into account approvals, authorizations, waivers or consents provided by local regulators. The Commission also proposed to amend Rule 15Fb2-1 to provide additional time for an SBS Entity to submit the certification and opinion of counsel required under Rule 15Fb2-4(c)(1).

#### 2. Commission Action

In response to the Commission's proposals, the commenters that addressed this issue recommended that the Commission eliminate the certification and opinion of counsel requirement, or eliminate the opinion of counsel requirement and modify the certification requirement, or revise or clarify the proposed guidance regarding the scope of the certification and opinion of counsel requirement.<sup>258</sup> The commenters stated that doing so would: harmonize with CFTC requirements;<sup>259</sup> level the playing field for U.S. and non-U.S. firms (which both operate internationally and are likely subject to the same foreign privacy, blocking and other laws);<sup>260</sup> reduce compliance costs;<sup>261</sup> reduce the market impacts of the possible withdrawal of participants unable to provide the certification and opinion;<sup>262</sup> and address concerns that the requirement, which would apply only with respect to nonresident SBS Entities, would violate national treatment principles.<sup>263</sup> Commenters also described foreign laws that would make it impossible for nonresident SBS Entities to comply with the rule.<sup>264</sup>

<sup>258</sup> See EBF letter at 2; letter from Manuel Rybach, Managing Director, Credit Suisse, and Jeffrey Samuel, Managing Director, UBS, dated July 23, 2019 ("Credit Suisse/UBS letter"); at 2; ISDA letter at 10; IIB/SIFMA letter at 18–20.

<sup>259</sup> See EBF letter at 2; Credit Suisse/UBS letter at 2.

<sup>260</sup> See ISDA letter at 10; Credit Suisse/UBS letter at 2.

<sup>261</sup> See IIB/SIFMA letter at 19; Credit Suisse/UBS letter at 2.

<sup>262</sup> See IIB/SIFMA letter at 19; Credit Suisse/UBS letter at 2.

<sup>263</sup> See IIB/SIFMA letter at 20.

<sup>264</sup> See, e.g., Credit Suisse/UBS letter at 2:

In principle, Swiss administrative law requires foreign authorities to seek administrative assistance when requesting data provision from Switzerland or on-site inspections in Switzerland. Additionally, Switzerland has a number of laws that are intended to protect the privacy of its customers and employees. These Swiss domestic laws may conflict with the Commission's Proposal. Most notably, Article 47 of the Swiss Federal Banking Act, to the extent customers have not waived such right, protects customer-related data from disclosure to any third-parties and applies to all banking institutions in Switzerland.

Some commenters urged the Commission to eliminate the certification and opinion of counsel requirement altogether.<sup>265</sup> One commenter recommended that the Commission eliminate the opinion of counsel requirement and adopt exclusions from the certification for competing blocking, privacy, or secrecy laws—similar to what the CFTC has done.<sup>266</sup> This approach was also suggested by another commenter as an alternative to elimination of the requirements.<sup>267</sup> Similarly, another commenter suggested that the Commission consider limiting the requirement to a certification of a senior officer, based on reasonable due diligence, that the SBS Entity will provide access to its U.S. business-related books and records to the Commission upon request.<sup>268</sup>

Upon consideration of the comments, the Commission is retaining the certification and opinion of counsel requirement of Exchange Act Rule 15Fb2-4 because, as we explained when we adopted the requirement, we believe that significant elements of an effective regulatory regime are the Commission's ability to access registered SBS Entities' books and records and to inspect and examine the operations of registered SBS Entities.<sup>269</sup> At the same time, the Commission is mindful of the concerns raised by commenters and therefore, as described below, is amending Rule 15Fb2-1 to: (1) Permit an SBS Entity to provide a conditional certification and opinion of counsel; and (2) upon the provision of such a conditional certification and opinion of counsel in connection with an otherwise complete application, conditionally register the SBS Entity. Furthermore, the Commission is also providing guidance regarding the application of the certification and opinion of counsel requirement (including the conditional

Article 271 of the Swiss Criminal Code also prevents "official acts" from being performed on behalf of a foreign authority on Swiss soil and poses an obstacle to the cross-border transmission of data located in Switzerland, in cases where the transmission of data has not been approved by Swiss authorities or the requirements of Article 42c and Article 42 Paragraph 2 of the Swiss Financial Market Supervision Act ("FINMASA") or the other administrative assistance requirements are not met. Finally, any on-site inspections performed in Switzerland on FINMA supervised entities by non-Swiss authorities are subject to the requirements of Article 43 FINMASA, and will always require varying degrees of FINMA involvement.

<sup>265</sup> See EBF letter at 2; Credit Suisse/UBS letter at 2; ISDA letter at 10.

<sup>266</sup> See IIB/SIFMA letter at 20.

<sup>267</sup> See Credit Suisse/UBS letter at 2.

<sup>268</sup> See ISDA letter at 10.

<sup>269</sup> Registration Adopting Release, 80 FR at 48981.

<sup>257</sup> See Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 75611 (Aug. 5, 2015), 80 FR 48964, 48981 (Aug. 14, 2015) ("Registration Adopting Release").

certification and opinion of counsel under Rule 15Fb2–1, as amended).

*B. Amendment to Rule 15Fb2–1  
Providing for a Conditional Certification  
and Opinion of Counsel*

1. Proposed Approach

In the Proposing Release the Commission acknowledged that a nonresident SBS Entity may be unable to provide the certification and opinion of counsel required under Rule 15Fb2–4(c)(1)<sup>270</sup> by the time the entity would be required to register because efforts to address legal barriers to the Commission’s access to books and records are still ongoing.<sup>271</sup> The Commission recognized, in the Proposing Release, that absent relief such nonresident SBS Entities could bear the cost of lowering or restructuring their market activities below the annual thresholds that would trigger registration requirements, an outcome that could create significant market disruptions.<sup>272</sup>

Given that, the Commission proposed to amend Exchange Act Rule 15Fb2–1 to provide additional time for a nonresident SBS Entity to submit the certification and opinion of counsel required under Rule 15Fb2–4(c)(1). Specifically, the Commission proposed new paragraphs (d)(2) and (e)(2) of Exchange Act Rule 15Fb2–1. Proposed paragraph (d)(2) would have provided that a nonresident applicant that is unable to provide the certification and opinion of counsel required under Rule 15Fb2–4(c)(1) shall be conditionally registered for up to 24 months after the compliance date for Rule 15Fb2–1 if the applicant submits a Form SBSE–C and a Form SBSE, SBSE–A or SBSE–BD, as applicable, that is complete in all respects but for the failure to provide the certification and the opinion of counsel required by Rule 15Fb2–4(c)(1). Proposed paragraph (e)(2) would have provided that if a nonresident SBS Entity became conditionally registered

in reliance on paragraph (d)(2) and provides the certification and opinion of counsel required by Rule 15Fb2–4(c)(1) within 24 months of the compliance date for Rule 15Fb2–1, the firm would remain conditionally registered until the Commission acts to grant or deny ongoing registration, and that if the nonresident SBS Entity fails to provide the certification and opinion of counsel within 24 months of the compliance date for Rule 15Fb2–1, the Commission may institute proceedings to determine whether ongoing registration should be denied. The Registration Adopting Release noted that once an SBS Entity was conditionally registered, all of the Commission’s rules applicable to registered SBS Entities would apply to the entity and it must comply with them.<sup>273</sup>

2. Commission Action

Only one commenter specifically addressed the proposed amendment, and that commenter did so in support of the proposal.<sup>274</sup> However, that commenter also requested that where a provisionally-registered SBS Entity has demonstrated best efforts but is nonetheless unable to furnish the certification and opinion of counsel within the 24-month grace period, the Commission should provide SBS Entities additional time in which to provide the certification and opinion of counsel.<sup>275</sup> More generally, as noted above, commenters have identified concerns with the certification and opinion of counsel requirement, and recommended that the Commission eliminate the requirement altogether, or else eliminate the opinion of counsel requirement and modify the certification requirement, or revise or clarify the proposed guidance regarding the scope of the certification and opinion of counsel requirement.<sup>276</sup> The commenters stated that doing so would, among other things, harmonize with CFTC requirements.<sup>277</sup> Commenters have expressed that the problem is not one of willingness to provide the certification and opinion of counsel at the time of registration, but rather the effect of privacy, blocking and secrecy laws, the EU General Data Protection Regulation (“GDPR”) and other legal impediments on the ability of a nonresident SBS Entity to provide the certification and opinion of counsel required by Rule 15Fb2–4(c). The CFTC

addressed this issue by creating an exception for “applicable blocking, privacy or secrecy laws” from its requirement that an applicant produce books and records in a timely fashion.

Accordingly, the Commission is adopting a modified approach, which is intended to achieve the same goal as the proposed amendment—providing relief to SBS Entities that are unable to provide the certification and opinion of counsel required under Rule 15Fb2–4(c)(1) by the time the entity would be required to register—but in a manner that more broadly addresses the concerns regarding the application of the certification and opinion of counsel requirement raised by commenters.<sup>278</sup>

Under Rule 15Fb2–1(d)(2) as adopted, a nonresident SBS Entity that is unable to provide the certification and opinion of counsel required by Rule 15Fb2–4(c) by the time the entity is required to register shall instead provide a conditional certification and opinion of counsel that identifies and is conditioned upon the occurrence of a future action that would provide the Commission with adequate assurances of prompt access to the books and records of the nonresident SBS Entity, and the ability of the nonresident SBS Entity to submit to onsite inspection and examination by the Commission. As set forth in Rule 15Fb2–1(d)(3), such future action could include: (1) Entry by the Commission and the foreign financial regulatory authority of the jurisdiction(s) in which the nonresident SBS Entity maintains the books and records that are addressed by the certification and opinion of counsel required by Rule 15Fb2–4 into a memorandum of understanding, agreement, protocol, or other regulatory arrangement providing the Commission with adequate assurances of (i) prompt access to the books and records of the nonresident SBS Entity, and (ii) the ability of the nonresident SBS Entity to submit to onsite inspection and examination by the Commission; (2) issuance by the Commission of an order granting substituted compliance in accordance with Rule 3a71–6 based on adequate assurances by the foreign financial authority in the jurisdiction(s) in which the nonresident SBS Entity maintains the books and records that are addressed by the certification and opinion of counsel required by Rule

<sup>270</sup> As described in the Registration Adopting Release, an SBS Entity is conditionally registered with the Commission when it submits a complete application on Form SBSE, SBSE–A, or SBSE–BD, as appropriate, and the Form SBSE–C senior officer certifications (see 17 CFR 240.15Fb2–1(d)). To be complete, a Form SBSE, SBSE–A, or SBSE–BD submitted by a nonresident SBS Entity would generally need to include the Schedule F certification and opinion of counsel.

<sup>271</sup> See Proposing Release, 84 FR at 24237. For example, the relevant regulatory authority in the foreign jurisdiction where the nonresident SBS Entity maintains its covered books and records may be in the process of (i) issuing an approval, authorization, waiver or consent or (ii) negotiating an MOU or other arrangement with the Commission.

<sup>272</sup> See Registration Adopting Release, 80 FR at 49008.

<sup>273</sup> See *id.* at 48970 n.52.

<sup>274</sup> See ISDA letter at 10.

<sup>275</sup> See *id.* at n.24.

<sup>276</sup> See EBF letter at 2; Credit Suisse/UBS letter at 2; ISDA letter at 10; IIB/SIFMA letter at 18–20.

<sup>277</sup> See EBF letter at 2; Credit Suisse/UBS letter at 2.

<sup>278</sup> See Proposing Release at 24236 (noting that an SBS Entity may be unable to provide the certification and opinion of counsel required by Exchange Act Rule 15Fb2–4(c)(1) by the time the entity is required to register because efforts to address legal barriers to Commission access are still ongoing).

15Fb2–4(c)(1);<sup>279</sup> or (3) any other action that would provide the Commission with assurances regarding prompt access to books and records and the ability to conduct onsite inspection and examination of the nonresident SBS Entity. Such “any other action” could be premised on, and take into account, the guidance the Commission is providing below and could include, for example, the subsequent receipt by the nonresident SBS Entity of consents on which it could premise a certification and opinion of counsel under Rule 15Fb2–4(c). The Commission is providing guidance below regarding the foreign laws to be addressed, and the scope of the books and records to be covered by the certification and opinion of counsel required by Rule 15Fb2–4(c)(1).

A nonresident SBS Entity that submits a conditional certification and opinion of counsel, in connection with an application that is complete in all respects but for the failure to provide the certification and the opinion of counsel required by Rule 15Fb2–4(c)(1), shall be conditionally registered. A nonresident SBS Entity that has become conditionally registered in reliance on this section will remain conditionally registered until the Commission acts to grant or deny ongoing registration. If none of the future actions that are included in an applicant’s conditional certification and opinion of counsel occurs within 24 months of the compliance date for Rule 15Fb2–1, and there is not otherwise a basis for concluding that the Commission will have the necessary access and ability to conduct onsite inspection and examination,<sup>280</sup> the Commission may institute proceedings thereafter to determine whether ongoing registration should be denied, in accordance with paragraph (e)(1) of the rule as amended.<sup>281</sup>

<sup>279</sup> Under Exchange Act Rule 3a71–6(c)(3), a foreign financial regulatory authority seeking a substituted compliance determination must provide “adequate assurances that no law or policy of any relevant foreign jurisdiction would impede the ability of any entity that is directly supervised by the foreign financial regulatory authority and that may register with the Commission as [an SBS Entity] to provide prompt access to such entity’s books and records or to submit to onsite inspection or examination by the Commission.”

<sup>280</sup> While not required, an applicant that is conditionally registered may amend its application if it subsequently becomes able to provide the certification and opinion of counsel contemplated by Exchange Act Rule 15Fb2–4(c).

<sup>281</sup> See Exchange Act Rule 15Fb2–1(e)(2). If there are extenuating circumstances such as, for example, where the foreign regulator has taken steps to issue an approval, authorization, waiver or consent or to enter into an MOU or other arrangement with the Commission, but has not yet completed that process, or the Commission has not yet completed

### *C. Foreign Laws to Be Addressed by the Certification and Opinion of Counsel*

#### 1. Proposed Guidance

The Commission proposed to provide guidance that it would be appropriate for the certification and opinion of counsel to address only the laws of the jurisdiction or jurisdictions in which a nonresident SBS Entity maintains its covered books and records as described in Part III.D. below (“covered books and records”).<sup>282</sup> The certification and opinion of counsel would not need to cover every jurisdiction where customers or counterparties of the nonresident SBS Entity may be located or where the nonresident SBS Entity may have additional offices or conduct business. Instead, they would only need to cover the jurisdiction(s) where the nonresident SBS Entity maintains its covered books and records, provided that the laws of the jurisdiction where the firm is incorporated or jurisdictions in which it is doing business would not prevent the Commission from having direct access to the covered books and records, nor prevent the nonresident SBS Entity from promptly furnishing them to the Commission or opening them up to the Commission for an onsite inspection or examination.

#### 2. Commission Action

Commenters expressed concerns that it could be difficult or costly for an SBS Entity to provide a certification and an opinion of counsel regarding the absence of any jurisdiction’s requirements that could prevent the SBS Entity from providing the Commission with prompt access to its records or to submit to onsite inspection and examination.<sup>283</sup> The Commission also recognizes that U.S. SBS Entities with operations in other countries may face similar issues but are not required to provide negative assurances regarding the ability of these other jurisdictions to affect Commission access to books and records. Given this, an SBS Entity’s certification and opinion of counsel need address only the jurisdiction(s) where the nonresident SBS Entity maintains its covered books and records (as discussed below). In this regard, the certification and opinion of counsel would need to address the laws of the jurisdiction(s) where the nonresident SBS Entity maintains its covered books and records. If a nonresident SBS Entity

its review of a substituted compliance application, the Commission would expect to take such circumstances into account when considering whether to institute such proceedings.

<sup>282</sup> Proposing Release, 84 FR at 24234.

<sup>283</sup> See EBF letter at 3–4; ISDA Letter at 11; IIB/SIFMA letter at 20–21.

maintains copies of the required records in multiple jurisdictions, the SBS Entity can elect to provide a certification and opinion of counsel with respect to laws of a single jurisdiction where the necessary access can be supported.<sup>284</sup>

The Commission notes that Exchange Act Section 15F(f)(1)(C) requires that an SBS Entity “shall keep books and records. . . . open to inspection and examination by any representative of the Commission.” Similarly, Exchange Act Rule 18a–6(g) provides that a nonresident SBS Entity “must furnish promptly to a representative of the Commission legible, true, complete, and current copies” of its books and records.<sup>285</sup> These obligations are independent of, and in addition to, the certification and opinion of counsel requirement.

### *D. Covered Books and Records*

#### 1. Proposed Guidance

In the Proposing Release, the Commission proposed to provide guidance that the certification and opinion of counsel need only address: (1) Books and records that relate to the “U.S. business” of the nonresident SBS Entity (as defined in 17 CFR 240.3a71–3(a)(8)); and (2) financial records necessary for the Commission to assess the compliance of the nonresident SBS Entity with capital and margin requirements under the Exchange Act and rules promulgated by the Commission thereunder, if these capital and margin requirements apply to the nonresident SBS Entity. The Commission stated that this guidance could help firms understand the scope of what is covered by the certification and opinion of counsel.

The Commission stated that it would be appropriate to tie the scope of the books and records covered by the certification and opinion of counsel to a firm’s “U.S. business” and relevant financial records to encompass those transactions that appear particularly likely to affect the integrity of the security-based swap market in the United States and the U.S. financial markets more generally or that raise concerns about the protection of participants in those markets.<sup>286</sup> The Commission indicated that following this approach would tailor the

<sup>284</sup> See EBF letter at 3; ISDA letter at 11–12.

<sup>285</sup> See Exchange Act Rule 18a–6(g) and discussion in Recordkeeping and Reporting Adopting Release.

<sup>286</sup> See Proposing Release, 84 FR at 24235 n.211 (citing Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 77617 (Apr. 14, 2016), 81 FR 29960, 30065 (May 13, 2016) (“Business Conduct Adopting Release”).

certification and opinion of counsel to the types of records the Commission would need to review, inspect or examine to determine compliance with applicable substantive requirements.

## 2. Commission Action

The Commission is providing guidance largely as proposed, with additional clarifications to respond to commenters. Thus, an SBS Entity's certification and opinion of counsel need only address the following records: (1) Books and records that relate to the "U.S. business" of the nonresident SBS Entity (as defined in 17 CFR 240.3a71-3(a)(8)); and (2) financial records necessary for the Commission to assess the compliance of the nonresident SBS Entity with applicable capital and margin requirements under the Exchange Act and rules promulgated by the Commission thereunder. The commenters that addressed this aspect of the proposed guidance asked that the certification and opinion of counsel not be required to cover any records maintained by a nonresident SBS Entity's U.S. registered broker-dealer or U.S. security-based swap dealer affiliate.<sup>287</sup> Upon consideration of the comments, we believe it would be appropriate to further clarify that the certification and opinion of counsel need not cover any books and records that are held in the United States, either directly, for example, in an office of the nonresident SBS Entity, or by an associated person of the nonresident SBS Entity or third party in accordance with Rule 18a-6(f).<sup>288</sup> To the extent books and records are maintained in the

United States in accordance with Commission rules, the Commission should be able to promptly access those records from the U.S. entity, and so there would be no need for the staff to seek to obtain them from the nonresident SBS Entity. The SBS Entity's certification and opinion of counsel would not need to address access to such books and records, except to represent that they are kept in the United States in accordance with Commission rules, but would still need to address the ability of the SBS Entity to submit to onsite inspections and examinations with respect to those books and records.

The Commission is not, however, accepting a suggestion to "exclude from the definition of covered books and records the financial records of a non-U.S. [security-based swap dealer] that is subject to the Commission's margin and capital requirements but relying on a substituted compliance determination with respect to [its] home country margin and capital requirements."<sup>289</sup> Substituted compliance is an alternative means of satisfying the Commission's capital and margin requirements. The Commission retains full authority over registered SBS Entities vis-à-vis the nonresident SBS Entity's compliance with those alternative margin and capital requirements, and Commission staff may need access to the relevant books and records to examine and assess the SBS Entity's compliance with applicable requirements. Accordingly, if a nonresident SBS Entity is subject to the Commission's margin and capital requirements, it is important that the certification and opinion of counsel address access to the covered books and records of that SBS Entity, even if the SBS Entity is relying on a substituted compliance determination with respect to its home country margin and capital requirements.

## E. Consents

### 1. Proposed Guidance

As explained in the Proposing Release, firms had noted that certain jurisdictions' laws may permit a firm to promptly provide access to books and records and to submit to an onsite inspection and examination, if the SBS Entity were to obtain consent from the natural person whose information is documented in the SBS Entity's books and records.<sup>290</sup> In response, the Commission stated its "preliminary belief" that it would be appropriate for an SBS Entity's certification and

opinion of counsel to be predicated, as necessary, on the SBS Entity obtaining the prior consent of the persons whose information is or will be included in the SBS Entity's books and records. The Proposing Release identified a number of concerns if an SBS Entity were to seek to rely on consents, and proposed guidance that a nonresident SBS Entity seeking to rely on consents, should obtain such consents prior to registering as an SBS Entity, and continue to obtain consents, as necessary, on an ongoing basis so that it would be able to continue to provide the Commission with access to books and records. The Commission noted that it is the SBS Entity's decision whether to rely on consents, and that a nonresident SBS Entity may also want to explore whether an alternative basis exists under the foreign privacy laws that would permit the nonresident SBS Entity to collect and maintain the necessary data and to provide the information directly to Commission staff.<sup>291</sup>

Finally, the Commission stated that a nonresident SBS Entity should, before registering with the Commission, assess whether it would be able to meet the obligation to provide the Commission with access to its books and records, and take appropriate steps to ensure that, if registered, it would be able to comply with them. For example, if a nonresident SBS Entity is unable to obtain consent from a customer or counterparty or if a customer or counterparty provides a consent then later withdraws that consent, the firm may need to cease conducting a security-based swap business with that person in order to comply with the Exchange Act and the Commission's rules thereunder or to seek an alternative basis under the foreign law(s) that allows the nonresident SBS Entity to satisfy its obligations under the federal securities laws.<sup>292</sup>

### 2. Commission Action

Commenters expressed concern with various aspects of the proposed guidance, in particular that: (1) Requiring SBS Entities to obtain consents prior to registration would be problematic, and the Commission should allow SBS Entities more time (one commenter suggested 24 months after registration) to obtain the required consents;<sup>293</sup> (2) the reliance on consents may not be a viable path forward due to the rules and guidance established under the GDPR and similar member

<sup>287</sup> See EBF letter at 3; ISDA letter at 12; IIB/SIFMA letter at 22.

<sup>288</sup> Exchange Act Rule 18a-6(f) provides:

(f) If the records required to be maintained and preserved pursuant to the provisions of §§ 240.18a-5 and 240.18a-6 are prepared or maintained by a third party on behalf of the security-based swap dealer or major security-based swap participant, the third party must file with the Commission a written undertaking in a form acceptable to the Commission, signed by a duly authorized person, to the effect that such records are the property of the security-based swap dealer or major security-based swap participant and will be surrendered promptly on request of the security-based swap dealer or major security-based swap participant and including the following provision:

With respect to any books and records maintained or preserved on behalf of [SBSD or MSBSP], the undersigned hereby undertakes to permit examination of such books and records at any time or from time to time during business hours by representatives or designees of the Securities and Exchange Commission, and to promptly furnish to said Commission or its designee true, correct, complete, and current hard copies of any or all or any part of such books and records.

Agreement with an outside entity will not relieve such security-based swap dealer or major security-based swap participant from the responsibility to prepare and maintain records as specified in this section or in § 240.18a-5.

<sup>289</sup> See IIB/SIFMA letter at 22.

<sup>290</sup> See Proposing Release, 84 FR at 24235.

<sup>291</sup> *Id.*

<sup>292</sup> See *id.*

<sup>293</sup> See EBF letter at 2, 5; ISDA letter at 13; IIB/SIFMA letter at 28.

state rules, because those consents must be given freely with the ability to withdraw the consent at any time;<sup>294</sup> (3) the Commission should not impose requirements regarding the method and frequency in which consent must be obtained, and SBS Entities should be able to obtain consent on a one-time basis through a protocol or disclosure-based regime and not be required to obtain consents on a transaction-by-transaction basis;<sup>295</sup> and (4) a withdrawal of consent by a counterparty should not affect transactions a security-based swap dealer had entered into with such counterparty when the counterparty's initial consent was in force.<sup>296</sup>

Nothing in the Exchange Act or the rules thereunder, or the guidance, requires an SBS Entity to obtain consents of the persons whose information is or will be included in its books and records. To the extent, however, such consents would allow the nonresident SBS Entity to promptly provide the Commission with access to its books and records and submit to on-site inspection and examination in the relevant jurisdiction, the Commission is providing guidance that the certification and opinion of counsel of a nonresident SBS Entity may be predicated upon the receipt of such consents.

The Commission is mindful of the concerns raised by commenters, but believes that, in addition to the requirements of Rule 15Fb2-4, the reliance on consents in providing the required certification and opinion of counsel regarding its covered books and records may implicate the underlying requirements of both Exchange Act Section 15F(f)(1)(C), which requires that an SBS Entity "shall keep books and records . . . open to inspection and examination by any representative of the Commission," and Exchange Act Rules 17a-4(j) and 18a-6(g), as relevant, under which a nonresident SBS Entity must "furnish promptly to a representative of the Commission legible, true, complete, and current copies" of its books and records. Accordingly, the Commission is clarifying that, when an SBS Entity is relying on consents in providing the required certification and opinion of counsel regarding its covered books and records, the SBS Entity should obtain consents in a time and manner consistent with the representations

made in the certification and opinion of counsel (such as, prior to entering into a transaction with counterparties for which the SBS Entity is relying on consents in providing the required certification and opinion of counsel regarding its covered books and records), in order to ensure Commission prompt access to books and records, regardless of whether the entity is conditionally or permanently registered.<sup>297</sup>

Similarly, to the extent an SBS Entity is relying on consents in providing the required certification and opinion of counsel regarding its covered books and records, it is not the Commission's intent that the withdrawal of consent by a counterparty should affect the validity of transactions entered into when the counterparty's consent was in force.<sup>298</sup> Nor does the Commission believe that a counterparty's withdrawal of consent would necessarily require amendment of an SBS Entity's certification and opinion of counsel under Rule 15Fb2-4(c)(2).<sup>299</sup> That said, the SBS Entity would still need to comply with the underlying requirements of Exchange Act Section 15F(f)(1)(C) and of Exchange Act Rule 18a-6(g), as discussed.<sup>300</sup> For that reason, as noted in the Proposing Release, a nonresident SBS Entity may also want to explore whether an alternative basis exists under the foreign privacy laws that would permit the nonresident SBS Entity to collect and maintain the necessary data and to provide the information to Commission staff.<sup>301</sup>

#### F. Open Contracts

##### 1. Proposed Guidance

In the Proposing Release, the Commission stated that it preliminarily believed that the certification and opinion of counsel would not need to address the books and records of

<sup>297</sup> The Commission is not addressing the method and frequency in which consent must be obtained.

<sup>298</sup> See IIB/SIFMA letter at 27-28.

<sup>299</sup> Exchange Act Rule 15Fb2-4(c)(2) requires a nonresident SBS Entity to re-certify and submit a revised opinion of counsel within 90 days after any changes in the legal or regulatory framework that would impact the SBS Entity's ability to provide, or the manner in which it provides the Commission prompt access to its books and records, or would impact the Commission's ability to inspect and examine the SBS Entity. If the SBS Entity is able to continue to meet its obligations notwithstanding the withdrawal of consent, such as for example if there is an MOU between the Commission and the relevant foreign financial regulator, a withdrawal of consent may not implicate Rule 15Fb2-4(c)(2).

<sup>300</sup> Because the final rules do not require an SBS Entity to obtain consents, the Commission is not adopting the commenter's suggestion that it exempt EU-based registrants from obtaining employee consents. See ISDA letter at 13.

<sup>301</sup> See Proposing Release, 84 FR at 24235.

security-based swap transactions that were entered into prior to the date on which a nonresident SBS Entity submits an application for registration pursuant to Section 15F(b) of the Exchange Act and the rules thereunder.<sup>302</sup> The Commission indicated that it recognizes there may be practical impediments to obtaining consents with respect to open contracts,<sup>303</sup> and that any potential application of these rules to open contracts could undermine the expectations that the parties had when entering into the security-based swap.

##### 2. Commission Action

The Commission is providing the guidance as proposed.<sup>304</sup> Thus, a nonresident SBS Entity's certification and opinion of counsel need not address records relating to security-based swap transactions entered into prior to the date on which a nonresident SBS Entity submits an application for registration pursuant to Section 15F(b) of the Exchange Act and the rules thereunder which the nonresident SBS Entity continues to hold on its books and records and under which it may have continuing obligations.

#### G. Memoranda of Understanding, Agreements, Protocols, or Other Regulatory Arrangements With Foreign Financial Regulatory Authorities

##### 1. Proposed Approach

The Commission stated in the Proposing Release that firms have indicated that while local laws or rules in some foreign jurisdictions may prevent a nonresident SBS Entity from providing the Commission with direct access to its books and records or submitting to onsite inspections or examinations, in some cases the relevant foreign financial regulatory authority may have entered into an MOU or other arrangement with the Commission to facilitate Commission access to records of nonresident SBS

<sup>302</sup> See *id.* See also Business Conduct Adopting Release, 81 FR at 29969, in which the Commission stated that the business conduct rules generally would not apply to any security-based swap entered into prior to the compliance date of the rules, and generally would apply to any security-based swap entered into after the compliance date of these rules, including a new security-based swap that results from an amendment or modification to a pre-existing security-based swap.

<sup>303</sup> For purposes of the proposed guidance, the term "open contracts" would have included any contract entered into by the SBS Entity prior to the date on which an SBS Entity submits an application for registration which the SBS Entity continues to hold on its books and records and under which it may have continuing obligations.

<sup>304</sup> The one commenter that addressed this issue indicated that it supported this proposed guidance. See IIB/SIFMA letter at 24.

<sup>294</sup> See EBF letter at 3; IIB/SIFMA letter at 23. One commenter asked the Commission to exempt EU-based registrants from obtaining employee consents because GDPR may prevent nonresident SBSs from obtaining such consents. See ISDA letter at 13.

<sup>295</sup> See ISDA letter at 13-14.

<sup>296</sup> See IIB/SIFMA letter at 27-28.

Entities located in the jurisdiction.<sup>305</sup> Those firms requested guidance regarding whether the certification and opinion of counsel submitted by a nonresident SBS Entity could rely on MOUs or other arrangements foreign financial regulatory authorities may have entered into with the Commission to facilitate Commission access to records at the request of the SBS Entity.

In the Proposing Release, the Commission stated that it preliminarily believes that it would be appropriate for the certification and opinion of counsel to take into account whether the relevant regulatory authority in the foreign jurisdiction has: (i) Issued an approval, authorization, waiver or consent; or (ii) entered into an MOU or other arrangement with the Commission facilitating direct access to the books and records of SBS Entities located in that jurisdiction, including the Commission's inspections and examinations at the offices of SBS Entities located in that jurisdiction, provided that such an approval, authorization, waiver, consent or MOU or arrangement is necessary to address legal barriers to the Commission's direct access to books and records of the SBS Entities in that jurisdiction.<sup>306</sup> However, the Commission noted that consideration of such an approval or MOU would need to be consistent with the Commission's registration program.

The Commission further stated in the Proposing Release that it would be appropriate to take into consideration an MOU or other arrangement that provided for consultation or cooperation with a foreign regulatory authority in conducting onsite inspections and examinations at the foreign offices of nonresident SBS Entities.<sup>307</sup> The Commission further noted that it also believed it would be consistent with its registration program if the Commission is required to notify the relevant foreign regulatory authority of its intent to conduct an onsite inspection or examination and staff from the foreign regulatory authority can accompany the Commission when it visits the foreign office of the nonresident SBS Entity.<sup>308</sup> However, the Commission indicated that it would not be consistent with its interpretation of the requirement to rely on an MOU or other arrangement if, whether by the terms of any relevant agreement, under provisions of local law, or in light of prior practice,

consultation or cooperation with the foreign regulatory authority restricts the Commission's ability to conduct timely inspections and examinations of the books and records in the foreign office of the nonresident SBS Entity.<sup>309</sup>

## 2. Commission Action

The commenters that addressed the issue supported the proposition that the certification and opinion of counsel could take into account MOUs with and others actions of the relevant foreign regulatory authorities.<sup>310</sup> In particular, commenters suggested that MOUs could help to facilitate the needed access to books and records. One commenter noted that "some conflicts with blocking and secrecy laws can be successfully addressed [with arrangements with home country regulators], resulting in direct access to records,"<sup>311</sup> while another recommended that the Commission allow the certification and opinion to rely on MOUs and similar tools because "the SEC may still obtain personal data through MOUs and other similar tools, which are permitted under GDPR."<sup>312</sup> A third commenter stated that the "Commission should address [ . . . ] conflicts with personal data protection laws through MOUs with the appropriate foreign regulatory agencies" because the MOUs would provide the Commission with "access to protected personal data."<sup>313</sup>

After consideration of these comments, the Commission is providing guidance, consistent with the standard we are adopting in Rule 15Fb2-1, as discussed above, that a nonresident SBS Entity's certification and opinion of counsel may take into account whether the relevant regulatory authority in a foreign jurisdiction has entered into a memorandum of understanding, agreement, protocol, or other regulatory arrangement providing the Commission with adequate assurances of (1) prompt access to the books and records of the nonresident SBS Entity, and (2) the ability of the nonresident SBS Entity to submit to onsite inspection or examination by the Commission. The certification and opinion of counsel may also take into account an applicant's understanding of the general experience with the foreign jurisdiction's application of the relevant local law or rule. Accordingly, if an applicant reasonably believes that there is nothing

in local law that would interfere with the Commission's ability to examine the applicant, the applicant may take into account that experience as well in making the certification or obtaining the opinion of counsel. An applicant could form a reasonable belief, for example, if it had been able to provide access to Commission staff or other U.S. regulators without difficulty in the past, and there have been no changes in local law that would materially alter the circumstances surrounding the applicant's past experience.

Again consistent with the standard we are adopting in Rule 15Fb2-1, the Commission believes that it is appropriate as well for a nonresident SBS Entity's certification and opinion of counsel to take into account a Commission determination granting substituted compliance, in accordance with Rule 3a71-6(c)(3), to a jurisdiction in which the SBS Entity maintains its covered books and records.

## H. Requests for Substituted Compliance

### 1. Proposed Approach

As noted in the Proposing Release, the guidance regarding the certification and opinion of counsel requirements in Rule 15Fb2-4 also would be relevant to Exchange Act Rule 3a71-6, which allows SBS Entities to comply with certain requirements under Section 15F of the Exchange Act through substituted compliance.<sup>314</sup> Paragraph (c)(2)(ii) of Rule 3a71-6 provides that substituted compliance requests by parties or groups of parties—other than foreign financial regulatory authorities—must include the certification and opinion of counsel required in connection with SBS Entity registration as if such party were subject to that requirement at the time of the request.<sup>315</sup> By contrast, substituted compliance requests submitted by foreign regulatory authorities are not required to be accompanied by a certification or opinion of counsel.<sup>316</sup> Rather, foreign financial regulatory authorities may make substituted compliance requests only if they provide adequate assurances that no law or policy of any relevant foreign jurisdiction would impede the ability of any entity that is directly supervised by the foreign financial regulatory authority and that may register with the Commission as an SBS Entity to provide the Commission with prompt access to the entity's books or records, or to submit to on-site inspection and examination by the

<sup>305</sup> See Proposing Release, 84 FR at 24235–36 n. 201, citing memoranda of meetings between Commission staff and market intermediaries.

<sup>306</sup> Proposing Release, 84 FR at 24236.

<sup>307</sup> *Id.*

<sup>308</sup> *Id.*

<sup>309</sup> *Id.*

<sup>310</sup> See EBF letter at 2–3; ISDA letter at 12; IIB/SIFMA letter at 23–24.

<sup>311</sup> See EBF Letter at 2–3.

<sup>312</sup> See ISDA Letter at 12.

<sup>313</sup> See IIB/SIFMA Letter at 24.

<sup>314</sup> Exchange Act Rule 3a71-6; see also Proposing Release, 84 FR at 24233–34.

<sup>315</sup> Exchange Act Rule 3a71-6(c)(2)(ii).

<sup>316</sup> Exchange Act Rule 3a71-6(c)(3).



Commission.<sup>317</sup> The Commission further explained in the Proposing Release that the guidance outlined in Parts III.C.1, III.D.1, III.E.1, III.F.1, and III.G.1 above regarding the application of the certification and opinion of counsel requirements would inform the Commission's assessment of any certification and opinion of counsel, or assurances from a foreign financial regulatory authority, submitted in connection with a substituted compliance request.<sup>318</sup>

In the Proposing Release, the Commission noted the time needed to consider substituted compliance requests and welcomed submission of substituted compliance requests with respect to any of its final rules for which substituted compliance is potentially available.<sup>319</sup> The Commission noted that it would consider all such requests, including those submitted without a certification or opinion of counsel, though a request by parties or groups of parties who are not foreign regulatory authorities would not be considered complete until a certification and opinion are filed.<sup>320</sup> Accordingly, the Commission encouraged potential applicants to begin the process of requesting substituted compliance as soon as practicable.<sup>321</sup> The Commission cautioned, however, that this did not mean that the Commission would grant any application for substituted compliance until any required certification and opinion of counsel are filed.<sup>322</sup>

## 2. Commission Action

The Commission continues to believe that the guidance outlined in Parts III.C to III.G above regarding the scope and content of the certification and opinion of counsel requirement in Rule 15Fb2-4 also should be relevant to any certification and opinion of counsel from a registrant or potential registrant pursuant to Exchange Act Rule 3a71-6(c)(2)(ii) in connection with a substituted compliance request. The certification and opinion of counsel required in connection with a substituted compliance request submitted by a party or group of parties other than a foreign financial regulatory authority are identical to the certification and opinion of counsel

required in connection with SBS Entity registration.<sup>323</sup>

Some commenters urged the Commission to revise Rule 3a71-6 so as to eliminate the requirement for a certification and opinion (in the case of substituted compliance requests made by parties or groups of parties who are not foreign financial regulatory authorities) and for adequate assurances (in the case of substituted compliance requests made by foreign financial regulatory authorities).<sup>324</sup> These commenters argued that the Commission no longer needs this certification and opinion or assurances, given the Commission's proposed 24-month grace period for delivery of the certification and opinion required in connection with registration of a non-resident SBS Entity, as discussed above in Part III.B.<sup>325</sup> Nevertheless, the certification, opinion of counsel, and assurances required in connection with substituted compliance applications remain relevant despite the Commission's adoption of changes to Exchange Act Rule 15Fb2-1. These requirements serve to assure the Commission regarding its ability to evaluate a registrant's compliance with the federal securities laws. For any requirements for which the Commission permits the use of substituted compliance, compliance with the federal securities laws would be measured by reference to the registrant's compliance with a foreign financial regulatory system. Any impediments to the Commission's ability to access a registrant's books and records thus could impede its ability to evaluate the registrant's compliance with the foreign

requirements. Further, unlike in the context of SBS Entity registration, Exchange Act Rule 3a71-6(a)(2)(ii) requires the Commission to enter into supervisory and enforcement cooperation arrangements as a necessary component of substituted compliance. In the substituted compliance context, impediments to the Commission's ability to access a registrant's books and records have the potential to impede effective cooperation with the relevant foreign financial regulatory authority. As the Commission noted when it proposed the substituted compliance framework, these cooperation arrangements were intended to express the commitment of the Commission and the foreign financial regulatory authority or authorities to cooperate with each other to fulfill their respective regulatory mandates.<sup>326</sup> This commitment, as expressed through the substituted compliance cooperation arrangement, is critical for the Commission to be able to interpret, evaluate, and enforce requirements for which substituted compliance is available. The Commission thus is retaining the certification, opinion, and adequate assurances requirements of Rule 3a71-6.

Commenters also argued that, if the Commission is unable to issue final substituted compliance determinations ahead of the compliance date for registration of SBS Entities, the Commission should issue temporary substituted compliance determinations for the same foreign requirements for which the CFTC has issued comparability determinations and related no-action relief regarding certain swap dealer requirements.<sup>327</sup> One commenter further suggested that all requests for substituted compliance submitted at least six months before the compliance date for SBS Entity registration and not adjudicated before that date should be deemed granted until 18 months after the Commission completes its review.<sup>328</sup> As discussed below in Part X.B, the Commission has considered commenters' concerns regarding the time needed to plan for SBS Entity registration, and is providing potential registrants more than 18 additional months to prepare for the compliance date for SBS Entity

<sup>323</sup> See Exchange Act Rule 3a71-6(c)(2)(ii). Similarly, the Commission continues to believe that relevant aspects of the guidance outlined in Parts III.D to III.F above should inform the Commission's assessment of whether a foreign financial regulatory authority has provided the assurances required pursuant to Exchange Act Rule 3a71-6(c)(3) in connection with a substituted compliance request submitted by a foreign financial regulatory authority.

<sup>324</sup> See EBF letter at 5-6 (arguing that the Commission no longer requires assurances regarding access to substituted compliance users' books and records given the Commission's proposal to permit a delay in the delivery of the certification and opinion of counsel required in connection with SBS Entity registration); IIB/SIFMA letter at 25 (arguing that the certification, opinion of counsel and assurances requirements served only to prevent the Commission from having to consider substituted compliance requests from a jurisdiction with legal barriers that prevent access to registrants' books and records); ISDA letter at 14-15 (arguing that the issues that would warrant delaying delivery of the certification and opinion of counsel required in connection with SBS Entity registration also would impede delivery of a certification and opinion of counsel in connection with substituted compliance requests).

<sup>325</sup> See EBF letter at 5-6; IIB/SIFMA letter at 25; ISDA letter at 14-15.

<sup>326</sup> See Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 69490 (May 1, 2013), 78 FR 30968, 31088 (May 23, 2013) ("Cross-Border Proposing Release").

<sup>327</sup> See EBF letter at 6; IIB/SIFMA letter at 32; ISDA letter at 15; Credit Suisse/UBS letter at 2-3.

<sup>328</sup> See IIB/SIFMA letter at 32.

<sup>317</sup> *Id.*

<sup>318</sup> See Proposing Release, 84 FR at 24233 & n.206.

<sup>319</sup> See Proposing Release, 84 FR at 24233-34.

<sup>320</sup> See *id.* at 24234. For the avoidance of doubt, Rule 15Fb2-1(d)(2) is not relevant to substituted compliance requests.

<sup>321</sup> See *id.*

<sup>322</sup> See *id.*

registration. The Commission believes that this time period also is sufficient for it to complete consideration of substituted compliance applications, and thus aims to complete consideration of timely substituted compliance applications in advance of the compliance date for SBS Entity registration. To achieve that goal, the Commission welcomes requests for substituted compliance ahead of the compliance date for SBS Entity registration, including those submitted without a certification or opinion of counsel, and encourages potential applicants to begin the process of requesting substituted compliance as soon as practicable.<sup>329</sup> The Commission expects to work closely with applicants for substituted compliance, including both potential registrants and relevant foreign financial regulatory authorities. Because the Commission does not expect its consideration of timely substituted compliance applications to be delayed beyond the compliance date for SBS Entity registration, the Commission believes it unnecessary to adopt a framework for provisional substituted compliance. Should the Commission determine that, despite diligent efforts of the staff, potential registrants, and authorities, it requires additional time to complete consideration of a substituted compliance application, appropriate relief tailored to specific circumstances may be considered.

#### *I. Other*

Rule 15Fb2-4(c)(2) requires a nonresident SBS Entity to re-certify within 90 days after any changes in the legal or regulatory framework that would impact the ability of the SBS Entity to provide, or the manner in which it would provide prompt access to its books and records, or would impact the ability of the Commission to inspect and examine the SBS Entity. The SBS Entity would be required as well to submit a revised opinion of counsel describing how, as a matter of law, the SBS Entity will continue to meet its obligations. Commenters have identified concerns with the rule as drafted, and provided thoughtful suggestions regarding steps the Commission could take to address the underlying concern of ensuring the Commission's continued prompt access to books and records and the ability of the SBS Entity to submit to onsite inspection and examination by the

Commission.<sup>330</sup> In this regard, the Commission will continue to remain available to provide assistance regarding issues that may arise in connection with the SBS Entity's obligation to update its certification and opinion of counsel upon changes in the relevant foreign laws.

#### **IV. Amendment to Commission Rule of Practice 194**

##### *A. Proposed Approach*

Commission Rule of Practice 194<sup>331</sup> governs the process by which SBS Entities may apply to the Commission for relief from the statutory disqualification prohibition set forth in Section 15F(b)(6) of the Exchange Act.<sup>332</sup> As outlined in the proposal, the Commission proposed new paragraph (c)(2) of Rule of Practice 194 to both (1) address concerns raised by commenters before and after the Commission adopted its SBS Entity registration rules relating to the application of the prohibition in Exchange Act Section 15F(b)(6) to associated persons of SBS Entities who are not U.S. persons and who do not interact with U.S. persons,<sup>333</sup> and (2) to harmonize the Commission's rules more closely with the CFTC's approach to statutory disqualification as it applies to the activities of non-U.S. associated persons.<sup>334</sup> As proposed, paragraph

<sup>330</sup> See IIB/SIFMA at 26–27. Among other things, IIB/SIFMA suggests that the Commission should clarify what would constitute a reasonable approach for a nonresident security-based swap dealer to identify changes in the laws covered by its certification and opinion of counsel, and that the nonresident security-based swap dealer conduct its review of applicable law in connection with the compliance review that would take place in connection with annual reports of the Chief Compliance Officer under Exchange Act Rule 15Fk-1(c). Under this approach, a nonresident security-based swap dealer would be required to notify the Commission of any issue within 90 days of the annual review and in connection with such notice, to propose a plan for addressing the issue.

<sup>331</sup> See Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons To Effect or Be Involved in Effecting Security-Based Swaps, Exchange Act Release No. 84858 (Dec. 19, 2018), 84 FR 4906–47. (Feb. 19, 2019) (“Rule of Practice 194 Adopting Release”).

<sup>332</sup> See 15 U.S.C. 78o-10(b)(6), which provides that, “[e]xcept to the extent otherwise specifically provided by rule, regulation, or order of the Commission, it shall be unlawful for a security-based swap dealer or a major security-based swap participant to permit any person associated with a security-based swap dealer or a major security-based swap participant who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the security-based swap dealer or major security-based swap participant, if the security-based swap dealer or major security-based swap participant knew, or in the exercise of reasonable care should have known, of the statutory disqualification.”

<sup>333</sup> See Proposing Release, 84 FR at 24238 n.235.

<sup>334</sup> See *id.* at 24238–39.

(c)(2) of Rule of Practice 194 would provide an exclusion, subject to certain limitations, from the statutory disqualification prohibition in Section 15F(b)(6) of the Exchange Act for an SBS Entity with respect to an associated person who is a natural person who (1) is not a U.S. person and (2) does not effect and is not involved in effecting security-based swap transactions with or for counterparties that are U.S. persons, other than a security-based swap transaction conducted through a foreign branch of a counterparty that is a U.S. person.<sup>335</sup>

The Commission also proposed that an SBS Entity would not be able to avail itself of the exclusion from the prohibition in Exchange Act Section 15F(b)(6) set forth in proposed paragraph (c)(2) with respect to an associated person if that associated person is currently subject to an order described in subparagraphs (A) and (B) of Section 3(a)(39) of the Exchange Act,<sup>336</sup> with the limitation that an order by a foreign financial regulatory authority described in subparagraphs (B)(i) and (B)(iii) of Section 3(a)(39) shall only apply to orders by a foreign financial regulatory authority in the jurisdiction where the associated person is employed or located.<sup>337</sup>

##### *B. Commission Action*

In soliciting comments on proposed new paragraph (c)(2), the Commission noted that in the Registration Adopting Release, the Commission included an interpretation of the scope of the phrase “involved in effecting security-based swaps,” as that phrase is used in Exchange Act Section 15F(b)(6).<sup>338</sup> The Commission stated in the Registration Adopting Release that the term “involved in effecting security-based swaps” generally means engaged in functions necessary to facilitate the SBS Entity's security-based swap business, including, but not limited to the following activities: (1) Drafting and negotiating master agreements and confirmations; (2) recommending security-based swap transactions to counterparties; (3) being involved in executing security-based swap transactions on a trading desk; (4) pricing security-based swap positions; (5) managing collateral for the SBS Entity; and (6) directly supervising

<sup>335</sup> See *id.* at 24238–42, 24290.

<sup>336</sup> Generally, Exchange Act Section 3(a)(39) defines the circumstances that would subject a person to a statutory disqualification with respect to membership or participation in, or association with a member of, an SRO. See 15 U.S.C. 78c(a)(39).

<sup>337</sup> See Proposing Release, 84 FR at 24238–42, 24290.

<sup>338</sup> See *id.* at 24242 (Question 7).

<sup>329</sup> See Capital, Margin, and Segregation Adopting Release, 84 FR at 43957.

persons engaged in the above-described activities.<sup>339</sup> The Commission requested comment on whether, based on the above-mentioned interpretation: (1) There are additional categories of non-U.S. associated persons of an SBS Entity that should be excluded from the statutory disqualification prohibition in Section 15F(b)(6); and, (2) if so, to describe the functions carried out by such non-U.S. associated persons of an SBS Entity and why commenters believe those functions do not present the types of concerns addressed by the prohibition on associating with a statutorily disqualified person.<sup>340</sup>

Certain commenters addressed proposed Rule of Practice 194(c)(2) specifically.<sup>341</sup> Although all such commenters supported proposed Rule of Practice 194(c)(2), these commenters also expressed that the scope of non-U.S. associated persons subject to the Commission's statutory disqualification prohibition and questionnaire recordkeeping requirement is still overly broad.<sup>342</sup> These commenters requested that the Commission further narrow the scope of non-U.S. persons subject to these requirements to include only non-U.S. front-office associated persons who solicit or accept security-based swaps with U.S. persons or who supervise such persons and, in turn, to exclude non-U.S. middle- or back-office associated persons.<sup>343</sup> In general, the commenters state that including middle- and back-office functions within the scope of the statutory disqualification provision would sweep in numerous additional associated persons as compared to the CFTC's approach to the parallel statutory disqualification provision under the CEA.<sup>344</sup> These commenters suggest that, by modifying

proposed Rule of Practice 194(c)(2) to more closely track the CEA definition of "associated person of a swap dealer or major swap participant,"<sup>345</sup> the Commission could exclude non-U.S. middle- or back-office associated persons from the statutory disqualification prohibition and thus the questionnaire recordkeeping requirement.<sup>346</sup> They state that this approach would more closely harmonize the Commission's statutory disqualification prohibition with the CFTC's approach to its analogous statutory disqualification prohibition.<sup>347</sup>

For example, one commenter argues that including middle- and back-office functions within the scope of the statutory disqualification provision would sweep in "a great number of additional persons . . . because financial institutions tend not to organize those functions to be focused on a single jurisdiction such as the United States (e.g., when negotiating global master agreements), but rather serve the entire swap business holistically, and which tend to be harder to canvas under home country laws, given that they have no trading authority."<sup>348</sup> Similarly, another commenter argues that, with respect to these middle- or back-office associated persons, "[t]heir discretion is frequently constrained in respects that make the potential for bad acts that could harm counterparties very limited, not only through detailed procedures but also multiple layers of controls."<sup>349</sup> According to that commenter, while the benefits of subjecting these middle- or back-office associated persons to the statutory disqualification requirement in Section 15F(b)(6) would be relatively low, the costs of extending this

requirement to these associated persons, on the other hand, would be quite high.<sup>350</sup> This same commenter also states that the number of associated persons implicated by the Commission's current interpretation would be "significant," that many of them would be located outside the United States, and that these associated persons frequently perform functions for a broad range of products not limited to security-based swaps.<sup>351</sup>

In response to the proposal, European Commission staff asked certain EBF members to provide estimates of the number of associated persons that may be potentially impacted under four different scenarios: (Scenario 1) if proposed Rule of Practice 194(c)(2) is not adopted (*i.e.*, the status quo without proposed paragraph (c)(2)); (Scenario 2) if proposed Rule of Practice 194(c)(2) is adopted, as proposed, without modification; (Scenario 3) if proposed Rule of Practice 194(c)(2) is adopted, as proposed, but modified to also exclude associated persons involved in drafting and negotiating master agreements and confirmations and managing collateral for the SBS Entity; and (Scenario 4) if proposed Rule of Practice 194(c)(2) is adopted, as proposed, but modified to exclude all associated persons identified in Scenario 3, as well as associated persons involved in structuring or supervisory functions (*i.e.*, only sales and trading associated persons would be considered "involved in effecting" security-based swap transactions).<sup>352</sup> European Commission staff provided estimates from six unspecified EBF member firms, which show that adopting the amendment as proposed may reduce the number of associated persons impacted by the statutory prohibition by approximately 54%, with a range of estimates between 20% and 85%, as well as further reductions in the number of associated persons impacted by the prohibition for Scenarios 3 and 4, which are discussed below.<sup>353</sup>

After considering the commenters' views, the Commission is adopting Rule of Practice 194(c)(2) as proposed. As a threshold matter, in response to the commenters' general suggestion that the Commission modify proposed Rule of Practice 194(c)(2) to more closely track the CEA definition of "associated person of a swap dealer or major swap

<sup>339</sup> See *id.* at 24242, n. 268 (citing Registration Adopting Release, 80 FR at 48974, 48976); see also *id.* at 24213, n. 61.

<sup>340</sup> See *id.* at 24242.

<sup>341</sup> See EBF letter at 6; IIB/SIFMA letter at 5, 29–30; ISDA letter at 3, 16; see also email from Tilman Lueder, Head of Securities Markets Unit, European Commission, dated Sept. 10, 2019 ("European Commission email") (providing estimates from six unspecified EBF member firms on the number of associated persons potentially impacted under four possible scenarios, including adopting Rule of Practice 194(c)(2) as proposed or with further modifications to exclude certain middle- or back-office functions).

<sup>342</sup> See EBF letter at 6; IIB/SIFMA letter at 5, 30; ISDA letter at 3, 16.

<sup>343</sup> See EBF letter at 6; IIB/SIFMA letter at 5, 30; ISDA letter at 3, 16.

<sup>344</sup> See EBF letter at 6; IIB/SIFMA letter at 5, 30; ISDA letter at 3, 16. CEA Section 4s(b)(6) parallels the statutory disqualification prohibition under Exchange Act Section 15F(b)(6). See 7 U.S.C. 6s(b)(6); see also CFTC Regulation 23.22 (promulgating the statutory disqualification prohibition in CEA Section 4s(b)(6) under the CFTC's regulations).

<sup>345</sup> 7 U.S.C. § 1a(4) (with respect to the CEA, "[t]he term 'associated person of a swap dealer or major swap participant' means a person who is associated with a swap dealer or major swap participant as a partner, officer, employee, or agent (or any person occupying a similar status or performing similar functions), in any capacity that involves (i) the solicitation or acceptance of swaps; or (ii) the supervision of any person or persons so engaged"); see also 17 CFR 1.3 (CEA Regulation defining associated person of a swap dealer or major swap participant).

<sup>346</sup> See EBF letter at 6; IIB/SIFMA letter at 30; ISDA letter at 16.

<sup>347</sup> See EBF letter at 6; IIB/SIFMA letter at 30; ISDA letter at 16.

<sup>348</sup> EBF Letter at 6.

<sup>349</sup> IIB/SIFMA Letter at 30; see also *id.* (also suggesting that if the Commission does not adopt the commenter's recommendation, the Commission should instead adopt an exclusion for associated persons "who neither engage in these front office functions nor exercise managerial or other discretionary, supervisory authority over the" security-based swap business of an SBS Dealer in order to be consistent with FINRA's approach to operations professionals as provided in FINRA Rule 1220(b)(3)).

<sup>350</sup> See *id.* This commenter did not provide supporting data regarding the magnitude of these purported benefits or costs.

<sup>351</sup> *Id.* This commenter did not provide supporting data regarding the number of associated persons impacted by its recommendation.

<sup>352</sup> See European Commission email.

<sup>353</sup> See *id.*

participant,”<sup>354</sup> it is important to note that Exchange Act Section 3(a)(70) generally defines the term “persons associated with” an SBS Entity more broadly than the CEA defines associated person of a swap dealer or major swap participant.<sup>355</sup> The Exchange Act definition includes, among other persons, any employee of an SBS Entity,<sup>356</sup> while the CEA definition is limited to persons acting in any capacity that involves the solicitation or acceptance of swaps or the supervision of any person or persons so engaged.<sup>357</sup> However, the Exchange Act definition generally excludes persons performing functions that are solely clerical or ministerial, which would include middle- or back-office associated persons of SBS Entities solely performing such functions.<sup>358</sup>

Additionally, while the Commission adopted an exclusion for associated person entities in Rule of Practice 194(c)(1),<sup>359</sup> the Commission continues to believe that replacing an associated person that is a natural person that is effecting or involved in effecting security-based swap transactions because of a statutory disqualification would not create the same practical issues and possible market disruption as moving the services, such as cash and collateral management services, provided by an associated person entity to another entity.<sup>360</sup> Further, the Commission is not revising its prior interpretation of the scope of the phrase “involved in effecting security-based swaps,” as it is used in Exchange Act Section 15F(b)(6), by adopting the modifications to the proposal recommended by commenters.<sup>361</sup> Revising the Commission’s prior interpretation to either carve out all<sup>362</sup> or some<sup>363</sup> middle- or back-office functions would be inconsistent with

the Commission’s analogous interpretation of the term “effecting transactions” in the context of securities transactions.<sup>364</sup> As the Commission explained, effecting transactions in securities includes more than just executing trades or forwarding orders for execution.<sup>365</sup> Generally, effecting securities transactions also can include, for example, participating in the transactions through a number of activities such as screening potential participants in a transaction for creditworthiness, facilitating the execution of a transaction, and handling customer funds and securities.<sup>366</sup>

Moreover, revising the Commission’s interpretation as these commenters suggest would narrow the scope of the term “involved in effecting” such that it would have the same meaning as the term “effect.” However, as the Commission observed in the Registration Adopting Release, the statutory provision on disqualification in Section 15F(b)(6) of the Exchange Act includes the phrase “involved in effecting,” separately and in addition to “effecting.”<sup>367</sup> The Commission stated previously that it understands that the inclusion of two separate terms in Section 15F(b)(6) to mean that the terms have different meanings, and that the term “involved in effecting” includes a broader range of activities than simply “effecting” security-based swap transactions.<sup>368</sup> Accordingly, the Commission explained that “it would be inappropriate to focus solely on the persons that effect transactions and not also on those that are involved more broadly in these key aspects of the process necessary to facilitate transactions, because persons involved in these key aspects of the process have the ability, through their conduct (intentional or unintentional), to increase risks to investors, counterparties and the markets.”<sup>369</sup>

In addition, if any of the modifications recommended by these commenters are adopted, it would create an inconsistent application of the

statutory prohibition for associated persons involved in effecting security-based swap transactions with or for counterparties that are U.S. persons. That inconsistency would result in certain associated persons being excluded from the statutory prohibition—even though they are involved in the security-based swap market in the United States—simply because those persons are located outside the United States and their firms have organized their back-offices to service the entire swap and security-based swap business irrespective of jurisdiction.

As discussed in Part VI.C below, this inconsistency may result in competitive disparities between U.S. and non-U.S. statutorily disqualified persons in middle- and back-office functions. Indeed, based on the estimates provided to the European Commission by EBF member firms, the potential for competitive disadvantage is not trivial. For example, and as outlined in Part VI.C, two of the alternative scenarios provided by EBF member firms may reduce the scope of application of the statutory prohibition with respect to non-U.S. associated persons—even though they may be involved in the security-based swap market in the United States—by an average of 38%, for Scenario 3 relative to the proposal (with estimates ranging between 20% and 80% for Scenario 3), and by an average of 66% for Scenario 4 relative to the proposal (with estimates ranging of between 45% and 87% for Scenario 4).<sup>370</sup>

We also note that, even without the modification recommended by these commenters, the amendments to Rule 18a–5 as adopted, which are discussed below,<sup>371</sup> will reduce the burden on firms with respect to the questionnaire requirements for non-U.S. associated persons. For example, subparagraphs (a)(10)(iii)(B) and (b)(8)(iii)(B) to Rule 18a–5, as adopted, provide that a questionnaire or application for employment executed by an associated person who is not a U.S. person need not include all of the information described in paragraphs (a)(10)(i)(A) through (H) and (b)(8)(i)(A) through (H) of Rule 18a–5, unless the SBS Entity (1) is required to obtain such information under applicable law in the jurisdiction in which the associated person is employed or located or (2) obtains such information in conducting a background check that is customary for such firms in that jurisdiction, and the creation or

<sup>354</sup> See note 345, *supra*.

<sup>355</sup> Compare 15 U.S.C. 78c(a)(70) with 7 U.S.C § 1a(4).

<sup>356</sup> See 15 U.S.C. 78c(a)(70).

<sup>357</sup> See 7 U.S.C § 1a(4).

<sup>358</sup> See 15 U.S.C. 78c(a)(70)(B).

<sup>359</sup> See 17 CFR 201.194(c).

<sup>360</sup> See Rule of Practice 194 Adopting Release, at 4911; see also Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons To Effect or Be Involved in Effecting Security-Based Swaps, Exchange Act Release No. 75612 (Aug. 5, 2015), 80 FR 51684, 51695 (Aug. 25, 2015) (proposing release).

<sup>361</sup> See EBF letter at 6; IIB/SIFMA letter at 5, 29–30; ISDA letter at 3, 16.

<sup>362</sup> See EBF letter at 6; IIB/SIFMA letter at 5, 29–30; ISDA letter at 3, 16.

<sup>363</sup> See European Commission email (suggesting in Scenario 3, outlined above, excluding associated persons involved in drafting and negotiating master agreements and confirmations and managing collateral for the SBS Entity).

<sup>364</sup> See Registration Adopting Release, 80 FR at 48976, n. 99 (citing, for example, Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934, Exchange Act Release No. 44291 (May 11, 2001), 66 FR 27760, 27772–73 (May 18, 2001)).

<sup>365</sup> See *id.*

<sup>366</sup> See *id.* The Commission notes that we are not addressing broker-dealer registration here. As a general matter, broker-dealer registration will depend on the specific facts and circumstances of each particular situation.

<sup>367</sup> See Registration Adopting Release, 80 FR at 48976.

<sup>368</sup> See *id.*

<sup>369</sup> See *id.*

<sup>370</sup> See Part VI.C.3.f (Table 4, Panel B, of the Economic Analysis).

<sup>371</sup> See generally Part V.

maintenance of records reflecting that information would not result in a violation of applicable law in the jurisdiction in which the associated person is employed or located.<sup>372</sup>

Finally, and most importantly, the Commission believes that the modification recommended by these commenters would undermine important investor protections provided by the statutory disqualification provision in Section 15F(b)(6) of the Exchange Act. As the Commission noted in the Rule of Practice 194 Adopting Release, Exchange Act Section 15F(b)(6) is designed to limit the potential that associated persons who have engaged in certain types of “bad acts” will be able to negatively affect the security-based swap market and the participants in that market.<sup>373</sup> The Commission has also stated that it is concerned principally with those transactions that appear likely to affect the integrity of the security-based swap market in the United States and the U.S. financial markets more generally or that raise concerns about the protection of participants in those markets.<sup>374</sup> The Commission has also noted that the risk of fraud and other misconduct may be increased and the counterparty protection benefits of the disqualification provision may be reduced if, for instance, persons involved in structuring security-based swaps, facilitating execution, or handling customer funds and securities are excepted from the statutory disqualification provision.<sup>375</sup> For example, and as also discussed in Part VII.D below, allowing statutorily disqualified associated persons to manage the collateral for an SBS Entity in connection with security-based swap transactions with or for counterparties that are U.S. persons may give rise to higher compliance and counterparty risks to U.S. counterparties and, thus, the U.S. security-based swap market.<sup>376</sup>

The data outlined by the Commission in the Rule of Practice 194 Adopting Release suggests that, based on analogous disqualification review

processes in swap and broker-dealer settings, individuals engaged in misconduct are more likely to engage in repeated misconduct.<sup>377</sup> Similarly, the Commission noted that, although there is a dearth of evidence of misconduct in swap and security-based swap markets, the Commission recognizes research in other settings reflecting that: (1) Past misconduct may predict future misconduct risk; (2) markets may penalize some disclosed misconduct, and (3) market participants engaging in misconduct generally suffer reputational costs.<sup>378</sup> As a result, the Commission believes that the statutory disqualification and the inability to continue associating with SBS Entities may create disincentives for engaging in misconduct.

Accordingly, for the reasons discussed above, the Commission is adopting Rule of Practice 194(c)(2) as proposed.

## V. Modifications to Rule 18a–5

### A. Proposed Approach

In the Proposing Release the Commission proposed to modify proposed Rule 18a–5.<sup>379</sup> Exchange Act 18a–5 was originally proposed in the Recordkeeping and Reporting Proposing Release, which proposed recordkeeping, reporting, and notification requirements applicable to SBS Entities, securities count requirements applicable to certain SBS Entities, and additional recordkeeping requirements applicable to broker-dealers to account for their security-based swap and swap activities.<sup>380</sup> Rule 18a–5 has since been adopted.<sup>381</sup> As described in the Recordkeeping and Reporting Proposing Release, the Commission originally proposed Exchange Act Rule 18a–5 (patterned after Exchange Act Rule 17a–3, the recordkeeping rule for registered broker-dealers), to establish recordkeeping standards for stand-alone and bank SBS Entities.<sup>382</sup> As adopted, paragraphs (a)(10) and (b)(8) of Rule 18a–5 require that a stand-alone or bank SBS Entity, respectively, make and keep current a questionnaire or application for employment for each associated

person who effects or is involved in effecting security-based swaps on the SBS Entity’s behalf.<sup>383</sup> Rule 18a–5 requires that the questionnaire or application for employment include the associated person’s identifying information, business affiliations for the past ten years, relevant disciplinary history, relevant criminal record, and place of business, among other things.<sup>384</sup>

Based on comments received in response to the Recordkeeping and Reporting Proposing Release and the Cross-Border Proposing Release, the Commission proposed, in the Proposing Release, to modify proposed Rule 18a–5 to provide flexibility with respect to the questionnaire requirement as applied to certain associated persons of both stand-alone and bank SBS Entities.<sup>385</sup> Thus, the Commission proposed to modify proposed Rule 18a–5 by adding two subparagraphs to provide separate exemptions under both paragraph (a)(10) and paragraph (b)(8).

#### 1. Exemption Based on the Exclusion From the Prohibition Under Section 15F(b)(6)

As described in the Proposing Release, the questionnaire requirement is intended to serve as a basis for a background check of the associated person to verify that the person is not subject to statutory disqualification under Section 15(b)(6) of the Exchange Act, and so to support the certification required under Rule 15Fb6–2(b). The addition of subparagraphs (a)(10)(iii)(A) and (b)(8)(iii)(A) would provide that a stand-alone or bank SBS Entity is not required to make and keep current a questionnaire or application for employment with respect to an associated person if the stand-alone or bank SBS Entity is excluded from the prohibition in Section 15F(b)(6) of the Exchange Act with respect to that associated person. These proposed modifications were designed to complement the Commission’s proposed amendments to Rule of Practice 194, which would have provided an exclusion from the prohibition in Section 15F(b)(6) of the Exchange Act with respect to an associated person who is not a U.S. person and does not effect and is not involved in effecting security-based

<sup>372</sup> See *id.* As discussed below, these subparagraphs would apply to an associated person who is not a U.S. person (as defined in Exchange Act Rule 3a71–3(a)(4)(i)(A)) that effects or is involved in effecting security-based swaps transactions on behalf of an SBS Entity with certain U.S. persons.

<sup>373</sup> See Rule of Practice 194 Adopting Release, 84 FR at 4909.

<sup>374</sup> See Proposing Release, 84 FR at 24215 n. 79 (citing Business Conduct Adopting Release, 81 FR at 30065); see also *id.* at 24235, 24240 (discussing the same).

<sup>375</sup> See Registration Adopting Release, 80 FR at 49011.

<sup>376</sup> See, e.g., *id.* at 48976.

<sup>377</sup> See Rule of Practice 194 Adopting Release, 84 FR at 4928–33.

<sup>378</sup> See *id.* at 4923.

<sup>379</sup> See Proposing Release, 84 FR at 24242.

<sup>380</sup> See Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers; Capital Rule for Certain Security-Based Swap Dealers, Exchange Act Release No. 91958 (Ap. 13, 2014), 79 FR at 25205 (May 2, 2014) (“Recordkeeping and Reporting Proposing Release”).

<sup>381</sup> See Recordkeeping and Reporting Adopting Release.

<sup>382</sup> See Recordkeeping and Reporting Proposing Release, 79 FR at 25205

<sup>383</sup> See Recordkeeping and Reporting Adopting Release, 84 FR at 68558 (“these associated person recordkeeping requirements apply to natural persons and not to legal entities that may be associated persons.”).

<sup>384</sup> See Exchange Act Rule 18a–5(a)(10) and (b)(8), Recordkeeping and Reporting Adopting Release, 84 FR at 68558.

<sup>385</sup> See Proposing Release, 84 FR at 24242.

swap transactions with or for counterparties that are U.S. persons, other than a security-based swap transaction conducted through a foreign branch of a counterparty that is a U.S. person, subject to certain conditions.

As a result, under proposed subparagraphs (a)(10)(iii)(A) and (b)(8)(iii)(A), a stand-alone or bank SBS Entity generally would not be required to obtain the questionnaire or application for employment, otherwise required by Rule 18a-5, with respect to any associated person who is not a U.S. person and who does not effect and is not involved in effecting security-based swap transactions with or for counterparties that are U.S. persons (other than a security-based swap transaction conducted through a foreign branch of a counterparty that is a U.S. person), subject to certain conditions. More specifically, proposed subparagraphs (a)(10)(iii)(A) and (b)(8)(iii)(A) would have provided that a stand-alone or bank SBS Entity would not be required to make and keep current a questionnaire or application for employment with respect to any associated person if the SBS Entity is excluded from the prohibition in Exchange Act 15F(b)(6) with respect to that associated person.

## 2. Exemption Based on Local Law

The Commission also proposed to modify Rule 18a-5 by adding subparagraphs (a)(10)(iii)(B) and (b)(8)(iii)(B) to address situations where the law of a non-U.S. jurisdiction in which an associated person is employed or located may prohibit a stand-alone or bank SBS Entity from receiving, creating or maintaining a record of any of the information mandated by the questionnaire requirement. These subparagraphs would apply to an associated person who is not a U.S. person (as defined in Exchange Act Rule 3a71-3(a)(4)(i)(A)),<sup>386</sup> and who effects or is involved in effecting security-based swaps transactions on behalf of an SBS Entity. As proposed, the addition of subparagraphs (a)(10)(iii)(B) and (b)(8)(iii)(B) to Rule 18a-5 would have permitted the exclusion of certain information mandated by the questionnaire requirement with respect to those associated persons if the receipt of that information, or the creation or maintenance of records reflecting such information, would result in a violation of applicable law in the jurisdiction in which the associated person is

employed or located.<sup>387</sup> As explained in the Proposing Release, rather than fully excluding these associated persons from the questionnaire requirement, the exclusion would provide that the stand-alone or bank SBS Entity need not record information mandated by the questionnaire requirement with respect to such associated persons if the receipt of that information, or the creation or maintenance of records reflecting such information, would result in a violation of applicable law in the jurisdiction in which the associated person is employed or located.<sup>388</sup>

The Commission explained that this proposed change was designed to address commenters' concerns, and would provide stand-alone and bank SBS Entities with flexibility to not record information that might result in a violation of the law in the jurisdiction in which the associated person is employed or located, while continuing to require that they record information not restricted by the law in that jurisdiction. In addition, the Commission stated that stand-alone and bank SBS Entities should still make and keep current information included in the questionnaire requirement that would not result in a violation of local law.

## B. Commission Action

The Commission solicited comment on all aspects of these proposed modifications to Rule 18a-5. Two commenters wrote in support of this proposed rule change.<sup>389</sup> One commenter requested that the Commission further clarify that, in performing reasonable due diligence, SBS Entities are not expected to take actions that would violate applicable privacy laws in the jurisdiction where the associated person is located or employed.<sup>390</sup>

For the reasons discussed in the proposal,<sup>391</sup> and after consideration of the comments, the Commission is adopting these new subparagraphs to Rule 18a-5, but is modifying subparagraphs (a)(10)(iii)(B) and

(b)(8)(iii)(B) to provide that a questionnaire or application for employment executed by an associated person who is not a U.S. person need not include the information described in paragraphs (a)(10)(i)(A) through (H) and (b)(8)(i)(A) through (H) of Rule 18a-5, unless the SBS Entity (1) is required to obtain such information under applicable law in the jurisdiction in which the associated person is employed or located or (2) obtains such information in conducting a background check that is customary for such firms in that jurisdiction, and the creation or maintenance of records reflecting that information would not result in a violation of applicable law in the jurisdiction in which the associated person is employed or located. We modified these paragraphs to provide greater clarity as to what information, generally required by 18a-5(a)(10)(i) and (b)(8)(i), an SBS Entity could exclude from an employee's questionnaire or application.

Every SBS Entity must still comply with Section 15F(b)(6) of the Exchange Act and Rule 15Fb6-2 with respect to every associated person who effects or is involved in effecting security-based swaps on behalf of the SBS Entity absent an exclusion from the statutory disqualification prohibition in Section 15F(b)(6) of the Exchange Act, in which case, as set forth in subparagraphs (a)(10)(iii)(A) and (b)(8)(iii)(A), the SBS Entity is not required to make and keep current a questionnaire or application for employment executed by an associated person. The questionnaire requirement is, in part, designed to serve as a basis for a background check of the associated person who is a natural person and who effects or is involved in effecting security-based swap transactions on the SBS Entity's behalf to verify that the person is not subject to statutory disqualification. As we explained in the Registration Adopting Release, the rules do not specify what steps an SBS Entity should take to perform a background check.<sup>392</sup> While the required employment questionnaire or application includes a significant amount of information that can be helpful to determine whether an associated person may be subject to a statutory disqualification, we believe financial institutions already take steps to verify the background of their employees.<sup>393</sup> Firms have flexibility in the manner in which they perform background checks, as long as those checks provide them with sufficient comfort to certify that none of the SBS

<sup>386</sup> Exchange Act Rule 3a71-3(a)(4)(i)(A) defines the term U.S. person to mean, with respect to natural persons, "a natural person resident in the United States."

<sup>387</sup> The SBS Entity would still need to record, on the questionnaire or application, information that would not violate local law (an associated person's name, address, etc.).

<sup>388</sup> To the extent an nonresident SBS Entity is able to rely on either paragraph (a)(10)(iii)(A) or (b)(8)(iii)(A) with respect to a particular associated person, the Commission explained that firm would not need to also rely on the relief provided under (a)(10)(iii)(B) or (b)(8)(iii)(B) because the firm would be exempt from the questionnaire requirement with respect to that associated person. See Proposing Release, 84 FR at 24243, n.281.

<sup>389</sup> See EBF letter at 6-7; IIB/SIFMA letter at 30.

<sup>390</sup> See EBF letter at 7.

<sup>391</sup> See Proposing Release, 84 FR at 24243-4.

<sup>392</sup> Registration Adopting Release, 80 FR at 48977.

<sup>393</sup> *Id.*

Entity's employees who effect or are involved in effecting security-based swaps on the SBS Entity's behalf is subject to a statutory disqualification, except as specifically permitted by rule, regulation or order of the Commission.<sup>394</sup>

We further believe that such background checks conducted using procedures that are either legally required or customary in the relevant non-U.S. jurisdictions, as outlined above in new subparagraphs (a)(10)(iii)(B) and (b)(8)(iii)(B) to Rule 18a-5,<sup>395</sup> would constitute reasonable due diligence on which a Chief Compliance Officer (or his or her designee)<sup>396</sup> could rely, in the absence of red flags that are in the firm's possession, when signing the associated person certification required by Rule 15Fb6-2.<sup>397</sup>

## VI. Economic Analysis

The Commission is mindful of the economic effects, including the costs and benefits, of the adopted

amendments and guidance. Section 3(f) of the Exchange Act provides that whenever the Commission is engaged in rulemaking pursuant to the Exchange Act and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.<sup>398</sup> In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact such rules would have on competition.<sup>399</sup> Exchange Act Section 23(a)(2) also provides that the Commission shall not adopt any rule which would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The analysis below addresses the likely economic effects of the adopted amendments, including the anticipated and estimated benefits and costs of the amendments and their likely effects on efficiency, competition, and capital formation. The Commission also discusses the potential economic effects of certain alternatives to the approaches taken in this release. The Commission is providing guidance and interpretive positions in this release. Any comments on the substance of the guidance and interpretations are discussed above.<sup>400</sup> To the extent that a regulated person would have acted differently than what is provided in the interpretations, there may be economic consequences attached to the rules as interpreted.

Many of the benefits and costs discussed below are difficult to quantify. For example, the Commission cannot quantify the costs that potentially could result from competitive disparities associated with the exception to Rule 3a71-3 because these costs will depend, in part, on foreign regulatory requirements applicable to non-U.S. entities. This is because the extent to which a non-U.S. entity would need to develop or modify systems to allow it and its majority-owned affiliate to meet the conditions of the exception likely depends on the extent to which the non-U.S. entity's local regulatory obligations differ from analogous conditions of the exception. These potential costs could also depend on the business decisions of non-U.S. persons that may avail themselves of the exception. Furthermore, the likelihood of a non-U.S. entity availing itself of the

exception depends on whether the non-U.S. entity is regulated in a listed jurisdiction, a determination that, in turn, depends on the foreign regulatory regime. Also, in connection with the amendments to Commission Rule of Practice 194, the Commission has no data or information allowing us to quantify the number of disqualified non-U.S. employees transacting with foreign counterparties or foreign branches of U.S. counterparties on behalf of U.S. and non-U.S. SBS Entities; the direct costs of relocating disqualified U.S. personnel outside of the United States for U.S. and non-U.S. SBS Entities; or reputational and compliance costs of U.S. and non-U.S. SBS Entities from continuing to transact through disqualified non-U.S. associated persons with foreign counterparties and foreign branches of U.S. counterparties. Therefore, while the Commission has attempted to quantify economic effects where possible, much of the discussion of economic effects is qualitative in nature.

### A. Baseline

To assess the economic effects of the amendments, the Commission is using as the baseline the security-based swap market as it exists at the time of this release, including applicable rules the Commission has already adopted, but excluding rules the Commission has proposed but not yet finalized. The analysis includes the statutory provisions that currently govern the security-based swap market pursuant to the Dodd-Frank Act and rules adopted in the Intermediary Definitions Adopting Release,<sup>401</sup> the Cross-Border Adopting Release, the SDR Rules and Core Principles Adopting Release,<sup>402</sup> and the Rule of Practice 194 Adopting Release.<sup>403</sup> Additionally, the baseline includes rules that have been adopted but for which compliance is not yet required, including the ANE Adopting Release, Registration Adopting Release,<sup>404</sup> Regulation SBSR Amendments Adopting Release,<sup>405</sup>

<sup>401</sup> See Intermediary Definitions Adopting Release, 77 FR at 30596.

<sup>402</sup> See Security-Based Swap Data Repository Registration, Duties, and Core Principles, Exchange Act Release No. 74246 (Feb. 11, 2015), 80 FR 14438 (Mar. 19, 2015) ("SDR Rules and Core Principles Adopting Release").

<sup>403</sup> See Rule of Practice 194 Adopting Release, 84 FR at 4906.

<sup>404</sup> See Registration Adopting Release, 80 FR 48964.

<sup>405</sup> See Reporting and Dissemination of Security-Based Swap Information, Exchange Act Release No. 78321 (Jul. 14, 2016), 81 FR 53546, 53590-91 (Aug. 12, 2016) ("Regulation SBSR Amendments Adopting Release").

<sup>394</sup> *Id.*

<sup>395</sup> Exchange Act Rule 18a-5 requires that SBS Entities maintain records that provide a basis for assessing compliance with the statutory disqualification prohibition set forth in Section 15F(b)(6) of the Exchange Act and related Exchange Act Rule 15Fb6-2. See Recordkeeping and Reporting Adopting Release, 84 FR at 68558. Accordingly, and as provided in new subparagraphs (a)(10)(iii)(B) and (b)(8)(iii)(B) of Rule 18a-5, if an SBS Entity is (1) required to obtain the information described in paragraphs (a)(10)(i)(A) through (H) and (b)(8)(i)(A) through (H) under applicable law in the jurisdiction in which the associated person is employed or located or (2) obtains such information in conducting a background check that is customary for such firms in that jurisdiction, Rule 18a-5 requires such SBS Entity to create and maintain a record reflecting that information, unless the creation or maintenance of records reflecting that information would result in a violation of applicable law in the jurisdiction in which the associated person is employed or located.

<sup>396</sup> Exchange Act Rule 15Fb6-2(b) requires that a registrant's Chief Compliance Officer "or his or her designee" must review and sign the questionnaire or application for employment. While the designee could be a person who reports directly to the Chief Compliance Officer, the Chief Compliance Officer also could designate a person such as a person in the registrant's Human Resources or other, similar department.

<sup>397</sup> Exchange Act Rule 15Fb6-2(b) provides: "(b) To support the certification required by paragraph (a) of this section, the security-based swap dealer's or major security-based swap participant's Chief Compliance Officer, or his or her designee, shall review and sign the questionnaire or application for employment, which the security-based swap dealer or major security-based swap participant is required to obtain pursuant to the relevant recordkeeping rule applicable to such security-based swap dealer or major security-based swap participant, executed by each associated person who is a natural person and who effects or is involved in effecting security based swaps on the security-based swap dealer's or major security-based swap participant's behalf. The questionnaire or application shall serve as a basis for a background check of the associated person to verify that the person is not subject to statutory disqualification."

<sup>398</sup> See 15 U.S.C. 78c(f).

<sup>399</sup> See 15 U.S.C. 78w(a)(2).

<sup>400</sup> See Parts II and III, *supra*.



Business Conduct Adopting Release,<sup>406</sup> Capital, Margin, and Segregation Adopting Release,<sup>407</sup> and the Recordkeeping and Reporting Adopting Release<sup>408</sup> as these final rules—even if compliance is not yet required—are part of the existing regulatory landscape that market participants expect to govern their security-based swap activity. The following sections discuss available data from the security-based swap market, security-based swap market participants and dealing structures, market-facing and non-market-facing activities of dealing entities, security-based swap market activity, global regulatory efforts, other markets and existing regulatory frameworks, estimates of persons that may use the exception to Rule 3a71–3, estimates of persons for which the Market Color Guidance may be relevant, statutory disqualification, certification, opinion of counsel, and employee questionnaires.

#### 1. Available Data From the Security-Based Swap Market

The Commission's understanding of the market is informed, in part, by available data on security-based swap transactions, though the Commission acknowledges that limitations in the data limit the extent to which it is possible to quantitatively characterize the market.<sup>409</sup> The Commission's analysis of the current state of the security-based swap market is based on data obtained from the DTCC Derivatives Repository Limited Trade Information Warehouse ("TIW"), especially data regarding the activity of market participants in the single-name CDS market during the period from 2008 to 2017. The details of this data set, including its limitations, have been discussed in a prior release.<sup>410</sup>

#### 2. Security-Based Swap Market: Market Participants and Dealing Structures

##### (a) Security-Based Swap Market Participants

Activity in the security-based swap market is concentrated among a relatively small number of entities that act as dealers in this market. In addition to these entities, thousands of other participants appear as counterparties to security-based swap contracts in the

TIW sample, and include, but are not limited to, investment companies, pension funds, private (hedge) funds, sovereign entities, and industrial companies. A discussion of security-based swap market participants can be found in a prior release.<sup>411</sup>

##### (b) Security-Based Swap Market Participant Domiciles

The security-based swap market is global in nature with participants from different countries transacting with one another. A discussion of the domicile of security-based swap market participants can be found in a prior release.<sup>412</sup>

##### (c) Market Centers

A market participant's domicile, however, does not necessarily correspond to where it engages in security-based swap activity. In particular, non-U.S. persons engaged in security-based swap dealing activity operate in multiple market centers and carry out such activity with counterparties around the world.<sup>413</sup> Many market participants that are engaged in dealing activity prefer to use traders and manage risk for security-based swaps in the jurisdiction where the underlying security is traded. Thus, although a significant amount of the dealing activity in security-based swaps on U.S. reference entities involves non-U.S. dealers, the Commission understands that these dealers tend to carry out much of the security-based swap trading and related risk-management activities in these security-based swaps within the United States.<sup>414</sup> Some dealers have explained that being able to centralize their trading, sales, risk management, and other activities related to U.S. reference entities in U.S. operations (even when the resulting transaction is booked in a foreign entity) improves the efficiency of their dealing business.

Consistent with these operational concerns and the global nature of the security-based swap market, the available data appear to confirm that participants in this market are in fact active in market centers around the globe. Although, as noted above, the available data do not permit us to identify the location of personnel in a transaction, TIW transaction records supplemented with legal entity location data indicate that firms that are likely to be security-based swap dealers operate

out of branch locations in key market centers around the world, including New York, London, Paris, Zurich, Tokyo, Hong Kong, Chicago, Sydney, Toronto, Frankfurt, Singapore, and the Cayman Islands.<sup>415</sup>

Given these market characteristics and practices, participants in the security-based swap market may bear the financial risk of a security-based swap transaction in a location different from the location where the transaction is arranged, negotiated, or executed, or where economic decisions are made by managers on behalf of beneficial owners. Market activity may also occur in a jurisdiction other than where the market participant or its counterparty books the transaction. Similarly, a participant in the security-based swap market may be exposed to counterparty risk from a counterparty located in a jurisdiction that is different from the market center or centers in which it participates.

##### (d) Common Business Structures

A non-U.S. person that engages in a global security-based swap dealing business in multiple market centers may choose to structure its dealing business in a number of different ways. This structure, including where it books the transactions that constitute that business and how it carries out market-facing activities that generate those transactions, reflects a range of business and regulatory considerations, which each non-U.S. person may weigh differently.

A non-U.S. person may choose to book all of its security-based swap transactions, regardless of where the transaction originated, in a single, central booking entity. That entity generally retains the risk associated with that transaction, but it also may lay off that risk to another affiliate via a back-to-back transaction or an assignment of the security-based swap.<sup>416</sup> Alternatively, a non-U.S. person may book security-based swaps arising from its dealing business in separate affiliates, which may be located in the jurisdiction where it originates the risk associated with the security-based swap, or, alternatively, the jurisdiction where it manages that risk. Some non-U.S. persons may book transactions originating in a particular region to an affiliate established in a

<sup>406</sup> See Business Conduct Adopting Release.

<sup>407</sup> See Capital, Margin, and Segregation Adopting Release, 84 FR 43872.

<sup>408</sup> See Recordkeeping and Reporting Adopting Release, 84 FR at 68550.

<sup>409</sup> The Commission also relies on qualitative information regarding market structure and evolving market practices provided by commenters and knowledge and expertise of Commission staff.

<sup>410</sup> See Recordkeeping and Reporting Adopting Release, 84 FR at 68623–24.

<sup>411</sup> See Rule of Practice 194 Adopting Release, 84 FR at 4925.

<sup>412</sup> See Capital, Margin, and Segregation Adopting Release, 84 FR at 43972.

<sup>413</sup> See ANE Adopting Release, 81 FR at 8604 n.56.

<sup>414</sup> See *id.* n.58.

<sup>415</sup> TIW transaction records contain a proxy for the domicile of an entity, which may differ from branch locations, which are separately identified in the transaction records. The legal entity location data are from Avox.

<sup>416</sup> See ANE Adopting Release, 81 FR at 8604.

jurisdiction located in that region.<sup>417</sup> A non-U.S. person may choose to book its security-based swap transactions in one jurisdiction in part to avoid triggering regulatory requirements associated with another jurisdiction.

Regardless of where a non-U.S. person determines to book its security-based swaps arising out of its dealing activity, it is likely to operate offices that perform sales or trading functions in one or more market centers in other jurisdictions. Maintaining sales and trading desks in global market centers permits the non-U.S. person to deal with counterparties in that jurisdiction or in a specific geographic region, or to ensure that it is able to provide liquidity to counterparties in other jurisdictions,<sup>418</sup> for example, when counterparty's home financial markets are closed. A non-U.S. person engaged in a security-based swap dealing business also may choose to manage its trading book in particular reference entities or securities primarily from a trading desk that can utilize local expertise in such products or that can gain access to better liquidity, which may permit it to more efficiently price such products or to otherwise compete more effectively in the security-based swap market. Some non-U.S. persons prefer to centralize risk management, pricing, and hedging for specific products with the personnel responsible for carrying out the trading of such products to mitigate operational risk associated with transactions in those products.

The non-U.S.-person affiliate that books these transactions may carry out related market-facing activities, whether in its home jurisdiction or in a foreign jurisdiction, using either its own personnel or the personnel of an affiliated or unaffiliated agent. For example, the non-U.S. person may determine that another of its affiliates employs personnel who possess expertise in relevant products or who have established sales relationships with key counterparties in a foreign jurisdiction, making it more efficient to use the personnel of the affiliate to engage in security-based swap market-facing activity on its behalf in that

jurisdiction. In these cases, the affiliate that books these transactions and its affiliated agent may operate as an integrated dealing business, each performing distinct core functions in carrying out that business.

Alternatively, the non-U.S.-person affiliate that books these transactions may in some circumstances determine to engage the services of an unaffiliated agent through which it can engage in market-facing activity. For example, a non-U.S. person may determine that using an interdealer broker may provide an efficient means of participating in the interdealer market in its own, or in another, jurisdiction, particularly if it is seeking to do so anonymously or to take a position in products that trade relatively infrequently.<sup>419</sup> A non-U.S. person may also use unaffiliated agents that operate at its direction. Such an arrangement may be particularly valuable in enabling a non-U.S. person to service clients or access liquidity in jurisdictions in which it has no security-based swap operations of its own.

The Commission understands that non-U.S.-person affiliates (whether affiliated with U.S.-based non-U.S. persons or not) that are established in foreign jurisdictions may use any of these structures to engage in dealing activity in the United States, and that they may seek to engage in dealing activity in the United States to transact with both U.S.-person and non-U.S.-person counterparties. In transactions with non-U.S.-person counterparties, these foreign affiliates may affirmatively seek to engage in dealing activity in the United States because the sales personnel of the non-U.S.-person dealer (or of its agent) in the United States have existing relationships with counterparties in other locations (such as Canada or Latin America) or because the trading personnel of the non-U.S.-person dealer (or of its agent) in the United States have the expertise to manage the trading books for security-based swaps on U.S. reference securities or entities. The Commission understands that some of these foreign affiliates engage in dealing activity in the United States through their personnel (or personnel of their affiliates) in part to ensure that they are able to provide their own counterparties, or those of non-U.S.-person affiliates in other jurisdictions,

with access to liquidity (often in non-U.S. reference entities) during U.S. business hours, permitting them to meet client demand even when the home markets are closed. In some cases, such as when seeking to transact with other dealers through an interdealer broker, these foreign affiliates may act, in a dealing capacity, in the United States through an unaffiliated, third-party agent.

### 3. Market-Facing and Non-Market-Facing Activities

As discussed in the Proposing Release, the activities of a security-based swap dealer involve both market-facing activities and non-market-facing activities.<sup>420</sup> Market-facing activities would include arranging, negotiating, or executing a security-based swap transaction. The terms “arrange” and “negotiate” indicate market-facing activity of sales or trading personnel in connection with a particular transaction, including interactions with counterparties or their agents. The term “execute” refers to the market-facing act that, in connection with a particular transaction, causes the person to become irrevocably bound under the security-based swap under applicable law. Non-market-facing activities include processing trades and other back-office activities; designing security-based swaps without engaging in market-facing activity in connection with specific transactions; preparing underlying documentation including negotiating master agreements (as opposed to negotiating with the counterparty the specific economic terms of a particular security-based swap transaction); and clerical and ministerial tasks such as entering executed transactions on a non-U.S. person's books.

### 4. Security-Based Swap Market Activity

As already noted, firms that act as dealers play a central role in the security-based swap market. These dealers transact with hundreds or a thousand or more counterparties. A discussion of activity in the security-based swap market is available in a prior release.<sup>421</sup>

### 5. Global Regulatory Efforts

The amendments and guidance relate to non-U.S.-person dealers that may be subject to foreign regulations of their security-based swap activities that are similar to regulations that may apply to them pursuant to Title VII. A discussion

<sup>417</sup> There is some indication that this booking structure is becoming increasingly common in the market. See, e.g., Catherine Contiguglia, “Regional Swaps Booking Replacing Global Hubs,” *Risk.net*, Sept. 4, 2015, <http://www.risk.net/risk-magazine/feature/2423975/regional-swaps-booking-replacing-global-hubs>. Such a development may be reflected in the increasing percentage of new entrants that have a foreign domicile, as described above.

<sup>418</sup> These offices may be branches or offices of the booking entity itself, or branches or offices of an affiliated agent, such as, in the United States, a registered broker-dealer.

<sup>419</sup> The Commission understands that interdealer brokers may provide voice or electronic trading services that, among other things, permit dealers to take positions or hedge risks in a manner that preserves their anonymity until the trade is executed. These interdealer brokers also may play a particularly important role in facilitating transactions in less liquid security-based swaps.

<sup>420</sup> See Proposing Release, 84 FR at 24215.

<sup>421</sup> See Recordkeeping and Reporting Adopting Release, 84 FR at 68625–27.

of foreign regulatory efforts, including margin and capital requirements, is available in a prior release.<sup>422</sup>

#### 6. Other Markets and Existing Regulatory Frameworks

The numerous financial markets are integrated, often attracting the same market participants that trade across corporate bond, swap, and security-based swap markets, among others. A discussion of other markets and existing regulatory frameworks can be found in a prior release.<sup>423</sup>

#### 7. Estimates of Persons That May Use the Exception to Rule 3a71–3

To analyze the economic effects of the exception to Rule 3a71–3, the Commission has analyzed 2017 TIW data to identify persons that may use the exception. The Commission believes that these persons fall into several categories, which are discussed below.

##### (a) Non-U.S. Persons Seeking to Reduce Assessment Costs

One category of persons that may use the exception are those non-U.S. persons that may need to assess the amount of their market-facing activity against the *de minimis* thresholds solely because of the inclusion of security-based swap transactions between two non-U.S. persons that are arranged, negotiated, or executed by personnel located in the U.S. for the purposes of the *de minimis* threshold analysis. These non-U.S. persons may have an incentive to rely on the exception as a means of avoiding assessment<sup>424</sup> and business restructuring if the cost of compliance associated with the exception is less than assessment costs and the costs of business restructuring. In the ANE Adopting Release, the Commission provided an estimate of this category of persons.<sup>425</sup> However, in light of the reduction in security-based swap market activity since the publication of the ANE Adopting

Release,<sup>426</sup> the Commission believes that it would be appropriate to update that estimate to more accurately identify the set of persons that potentially may use the exception. Analyses of the 2017 TIW data indicate that approximately five non-U.S. persons,<sup>427</sup> beyond those non-U.S. persons likely to incur assessment costs in connection with the other cross-border counting rules that the Commission previously had adopted in the Cross-Border Adopting Release,<sup>428</sup> are likely to exceed the \$2 billion threshold.<sup>429</sup> the Commission has previously employed to estimate the number of persons likely to incur assessment costs under Exchange Act Rule 3a71–3(b). These non-U.S. persons may have an incentive to rely on the exception as a means of avoiding assessment if the cost of compliance associated with the exception is less than the assessment costs.

##### (b) Non-U.S. Persons Seeking To Avoid Security-Based Swap Dealer Regulation

Another category of persons that potentially may use the exception are those non-U.S. persons whose dealing transaction volume would have fallen below the \$3 billion *de minimis* threshold if their transactions with non-U.S. counterparties were not counted toward the *de minimis* threshold under the current “arranged, negotiated, or executed” counting requirement, but absent the exception, would have dealing transactions in excess of that threshold.<sup>430</sup> Such non-U.S. persons may choose to use the exception if they expect the compliance cost associated with the exception to be lower than the compliance cost associated with being subject to the full set of security-based swap dealer regulation and the cost of business restructuring. The Commission’s analysis of 2017 TIW data indicates that there is one non-U.S. person whose transaction volume would have fallen below the \$3 billion *de minimis* threshold if that person’s transactions with non-U.S. counterparties were not counted toward the *de minimis* threshold under the current “arranged, negotiated, or executed” counting requirement.<sup>431</sup>

##### (c) U.S. Dealing Entities Considering Changes to Booking Practices

A third category of persons that potentially may use the exception are those U.S. dealers that use U.S. personnel to arrange, negotiate, or execute transactions with non-U.S. counterparties. Such dealers may consider booking future transactions with non-U.S. counterparties to their non-U.S. affiliates, while still using U.S. personnel to arrange, negotiate, or execute such transactions. These U.S. dealers may have an incentive to engage in such booking practices in order to utilize the exception to the extent that they wish to continue using U.S. personnel to arrange, negotiate, or execute transactions with non-U.S. counterparties and the compliance cost associated with the exception is less than the cost of compliance with Title VII requirements (if they choose not to book transactions to avail themselves of the exception) and the cost of business restructuring (if they choose to both book transactions to their non-U.S. affiliates and also refrain from using U.S. personnel to arrange, negotiate, or execute such transactions).<sup>432</sup> The Commission’s analysis of 2017 TIW data indicates that there are six U.S. dealers who transact with non-U.S. counterparties, who are likely to register as security-based swap dealers,<sup>433</sup> and have non-U.S. affiliates that also transact in the CDS market. To the extent that these U.S. dealers anticipate booking future transactions with non-U.S. counterparties that are arranged, negotiated, or executed by U.S. personnel to their non-U.S. affiliates, the Commission believes that these U.S. dealers may potentially make use of the exception.

persons against both U.S.-person and non-U.S.-person counterparties. The Commission then excluded transactions involving these non-U.S. persons and their non-U.S. person counterparties. For this analysis, we assume that all transactions between non-U.S. person dealers and non-U.S. counterparties are arranged, negotiated, or executed using U.S. personnel.

<sup>432</sup> The Commission recognizes that this potential use of the exception by U.S. dealing entities is distinct from the rationale underlying the exception, which is to help avoid market fragmentation and operational risks resulting from the relocation of U.S. personnel by non-U.S. dealers. See Proposing Release, 84 FR at 24231. Nonetheless, such changes in booking practices by U.S. dealing entities might be a consequence of the exception.

<sup>433</sup> To the extent that U.S. persons with transaction volumes that are insufficient to trigger dealer registration potentially might also make use of the exception, this estimate would be a lower bound estimate of the number of U.S. persons that potentially may make use of the exception.

<sup>422</sup> See Capital, Margin, and Segregation Adopting Release, 84 FR at 43979–80.

<sup>423</sup> See Rule of Practice 194 Adopting Release, 84 FR at 4927.

<sup>424</sup> These non-U.S. persons may incur assessment costs to determine whether their covered inter-dealer security-based swap positions exceed the \$50 billion cap (see Part II.C.1, *supra*). However, these non-U.S. persons may not find it necessary to count toward the \$50 billion threshold if their total covered inter-dealer security-based swap positions is less than \$50 billion or they restructure their security-based swap business to avoid engaging in such covered positions. To the extent that this is true, it may still benefit these non-U.S. persons to rely on the exception to avoid assessing the amount of security-based swap transactions between two non-U.S. persons that are arranged, negotiated, or executed by personnel located in the U.S. for the purposes of the *de minimis* threshold analysis.

<sup>425</sup> See ANE Adopting Release, 81 FR at 8627.

<sup>426</sup> See Part VI.A.4, *supra*.

<sup>427</sup> Adjustments to these statistics from the ANE Adopting Release reflect further analysis of the TIW data. Cf. ANE Adopting Release, 81 FR at 8627 (providing an estimate of 10 additional non-U.S. persons based on 2014 TIW data).

<sup>428</sup> See Proposing Release, 84 FR at 24208 n.13.

<sup>429</sup> See ANE Adopting Release, 81 FR at 8626.

<sup>430</sup> The \$3 billion threshold is being used to help identify potential impacts of the exception. A phase-in threshold of \$8 billion currently is in effect. See Exchange Act Rule 3a71–2(a)(1).

<sup>431</sup> The analysis begins by considering the single-name CDS transactions of each of the non-U.S.

## (d) Additional Considerations and Summary

The economic analysis of the exception depends, in part, on whether non-U.S. persons that might make use of the exception have U.S. affiliates that are likely to register as security-based swap dealers or are registered broker-dealer affiliates.<sup>434</sup> Of the six non-U.S.

persons discussed above,<sup>435</sup> four have majority-owned affiliates that are registered broker-dealers. Of the same six non-U.S. persons, one has a majority-owned affiliate that is likely to register as a security-based swap dealer. Of the six U.S. persons discussed above, all have majority-owned affiliates that are registered broker-dealers, and all have majority-owned affiliates that are

likely to register as security-based swap dealers. Of these 12 persons, eight are banks, and three are affiliated with banks. These estimates are summarized in Table 1 below. The Commission's analysis of the security-based swap market<sup>436</sup> indicates that these 12 persons transacted with 807 non-U.S. counterparties, of which 558 participate in the swap markets and 249 do not.

TABLE 1—AFFILIATES OF PERSONS THAT MAY USE THE EXCEPTION

Persons identified in TIW data that may use the exception	Non-U.S.	U.S.
Estimate .....	6	6
Breakdown:		
Has majority-owned registered broker-dealer affiliate .....	4	6
Has majority-owned affiliate likely to become registered security-based swap dealer .....	1	6
Is a bank .....	4	4
Is a bank affiliate .....	1	2

In summary, the Commission's analysis of 2017 TIW data indicates that 12 persons<sup>437</sup> may make use of the exception. In light of the uncertainty associated with this estimate<sup>438</sup> and to account for potential growth of the security-based swap market, and consistent with the approach in the ANE Adopting Release, the Commission believes that it is reasonable to increase this estimate by a factor of two.<sup>439</sup> As a result, the Commission estimates that up to 24 persons potentially may make use of the exception. The Commission also doubles the number of non-U.S. counterparties discussed above and estimates that persons that may make use of the exception may transact with up to 1,614 non-U.S. counterparties, of which 1,116 participate in the swap markets and 498 do not.<sup>440</sup> In response

to a commenter who noted the absence of an estimate of the security-based swap transaction activity potentially implicated by the exception,<sup>441</sup> the Commission is providing an estimate of the security-based swap transactions that the 24 persons may engage in with non-U.S. counterparties. The Commission estimates that these 24 persons may transact up to 97,894 security-based swap transactions with an aggregate notional amount of \$554 billion<sup>442</sup> with the 1,614 non-U.S. counterparties. The Commission estimates that these transactions make up between 4.7% and 13.1%<sup>443</sup> of the U.S. security-based swap market.

## 8. Statutory Disqualification

In the Rule of Practice 194 Adopting Release, the Commission analyzed,

among others, data on the number of natural persons associated with SBS Entities, applications for review under parallel review processes, and relevant research on statutory disqualification. In that release, the Commission estimated that SBS Entities may file up to five applications per year with respect to their associated natural persons. A more detailed discussion of these data and estimates can be found in that release.<sup>444</sup> If associated natural persons who become statutorily disqualified are located outside of the U.S. and effect or are involved in effecting transactions solely with foreign counterparties and foreign branches of U.S. counterparties, the amendment may decrease the number of these applications for relief and corresponding direct costs.

<sup>434</sup> As discussed in Part VI.B.1, *infra*, non-U.S. persons that already have an affiliated registered security-based swap dealer or affiliated registered broker-dealer likely would use their existing registered affiliates to rely on the exception rather than register new entities. For these non-U.S. persons, the costs of complying with the conditions associated with the exception likely would be lower than the per-entity costs reported in Table 3, which are based on the de novo formation of a security-based swap dealer or broker-dealer.

<sup>435</sup> Calculated as the 5 non-U.S. persons seeking to reduce assessment costs (see Part VI.A.7.a, *supra*) + 1 non-U.S. person seeking to avoid security-based swap dealer regulation (see Part VI.A.7.b, *supra*) = 6 non-U.S. persons.

<sup>436</sup> The analysis uses 2017 TIW data.

<sup>437</sup> Calculated as 5 non-U.S. persons seeking to reduce assessment costs (see Part VI.A.7.a, *supra*) + 1 non-U.S. person seeking to avoid security-based swap dealer regulation (see Part VI.A.7.b, *supra*) + 6 U.S. persons considering changes to booking practices (see Part VI.A.7.c, *supra*) = 12 persons.

<sup>438</sup> The estimate may be overinclusive, as it is unlikely that all transactions between two non-U.S. persons are arranged, negotiated, or executed by personnel located in a U.S. branch or office; it may also be underinclusive, as our TIW data do not include single-name CDS transactions between two

non-U.S. entities written on non-U.S. underliers, some of which may be arranged, negotiated, or executed by personnel located in a U.S. branch or office, or transactions on other types of security-based swaps (including equity swaps) whether on U.S. or non-U.S. underliers. See ANE Adopting Release, 81 FR at 8627.

<sup>439</sup> See *id.* The Commission does not believe increasing the estimate by a factor of two is arbitrary, as suggested by a commenter (see AFR letter at 4). The security-based swap market could grow in the future such that the number of persons that may use the exception could exceed the 12 persons that the Commission estimated from the 2017 TIW data. Further, as discussed in note 438, *supra*, there is uncertainty associated with the estimate of 12 persons due to limitations of the TIW data, which suggests that the number of persons that may use the exception could exceed 12. In light of these considerations and consistent with the approach in the ANE Adopting Release, the Commission believes that it is reasonable to increase the estimate by a factor of two.

<sup>440</sup> See Part VI.B.3.a, *infra*, where we use these estimates to calculate certain costs associated with an additional alternative.

<sup>441</sup> See AFR letter at 4.

<sup>442</sup> The Commission estimates that the 12 persons identified in the 2017 TIW data engaged in 48,947

single-name CDS transactions with an aggregate notional amount of \$277 billion with their non-U.S. counterparties. To address potential growth in the market and data related uncertainty, and consistent with the approach in the ANE Adopting Release, the Commission has doubled the number of transactions and aggregate notional amount to, respectively, 97,894 transactions and \$554 billion. See Part VI.A.4, *supra*.

<sup>443</sup> In the 2017 TIW data, the Commission estimates that there are 372,445 single-name CDS transactions with an aggregate notional amount of \$5,962 billion. To address potential growth in the market and data related uncertainty, and consistent with the approach in the ANE Adopting Release, the Commission estimates that there are  $372,445 \times 2 = 744,890$  security-based swap transactions with an aggregate notional amount of  $\$5,962 \text{ billion} \times 2 = \$11,924 \text{ billion}$  in the U.S. security-based swap market. In terms of transaction count, the set of security-based swap transactions that may be subject to the conditional exception makes up  $97,894 / 744,890 \times 100 = 13.1\%$  of the U.S. security-based swap market. In terms of aggregate notional amount, this set of transactions makes up  $554 / 11,924 \times 100 = 4.7\%$  of the U.S. security-based swap market.

<sup>444</sup> See Rule of Practice 194 Adopting Release, 84 FR at 4925.

The Commission has received comments<sup>445</sup> concerning the potential impact of the proposed approach on the

number of associated persons subject to the statutory prohibition relative to the

baseline, as summarized in Table 2 below.

TABLE 2—ESTIMATES OF ASSOCIATED PERSONS AFFECTED BY THE PROPOSAL<sup>446</sup>  
[Panel A. Market Participant Estimates of the Number of Associated Persons Affected by the Proposal]

Estimate	Bank 1	Bank 2	Bank 3	Bank 4	Bank 5	Bank 6
Baseline <sup>447</sup> .....	3,750	2,150–2,250	2,100	2,100	1,340	>6,800
Proposal <sup>448</sup> .....	1,125	1,350–1,400	700–800	<sup>449</sup> 1,680	650–750	>1,000

[Panel B. Percentage Reduction in Associated Persons Based on Data Provided by 6 Market Participants]<sup>450</sup>

Estimate	Average	Minimum	Maximum
Proposal .....	54%	20%	85%

In the proposing release, the Commission estimated that the exclusion may reduce the number of applications under Rule of Practice 194 by between zero and two applications. As summarized in Panel B of Table 2, the Commission has received estimates that the proposal may reduce the scope of associated persons subject to the statutory prohibition by an average of 54%, with a range of between 20% and 85%. In the Rule 194 Adopting Release that forms part of this economic baseline, the Commission estimated that there may be as many as 5 applications per year under Rule of Practice 194.<sup>451</sup> Using the estimate of 5 applications per year under the baseline and the above range of between 20% and 85% reduction in the scope of natural persons subject to the statutory prohibition relative to baseline, the Commission now estimates that adopting the proposed approach may reduce the number of applications under Rule of Practice 194 by between one and four applications.<sup>452</sup>

#### 9. Certification, Opinion of Counsel, and Employee Questionnaires

As a baseline matter, SBS Entity Registration rules, including Rule 15Fb2–1 and the certification and opinion of counsel requirements in Rule 15Fb2–4, have been adopted but compliance with registration rules is not yet required.

In addition, Rule 17a–3(a)(12) requires all broker-dealers, including

broker-dealers that may seek to register with the Commission as SBS Entities, to make and keep current a questionnaire or application for employment for each associated person. In the Recordkeeping and Reporting Adopting Release, the Commission adopted a parallel requirement, in Rule 18a–5, for stand-alone and bank SBS Entities. The Commission is adopting modifications to Rule 18a–5(a)(10) and Rule 18a–5(b)(8). Based on 2017 TIW data, of 22 non-U.S. persons that may register with the Commission as security-based swap dealers, the Commission estimates that approximately 12 security-based swap dealers will be foreign banks and another 3 will be foreign stand-alone security-based swap dealers that may be affected by these modifications.

#### B. Amendment to Rule 3a71–3

This section discusses the potential costs and benefits associated with the amendment to Rule 3a71–3 and the effects of the amendment on efficiency, competition, and capital formation.

Under the adopted alternative, each person that engages in arranging, negotiating, and executing activity with non-U.S. counterparties using affiliated U.S.-based personnel would have two possible options for complying with the Commission's Title VII regulations regarding the cross-border application of the "security-based swap dealer" definition. The first option would be for the persons to follow current security-based swap dealer counting

requirements without regard for the exception afforded by the amendment. Specifically, a person could opt to incur the assessment costs to determine (i) whether any portion of their security-based swap transaction activities must be counted against the dealer *de minimis* thresholds, and (ii) whether the total notional amount of relevant transaction activities exceeds the *de minimis* threshold.<sup>453</sup> If the amount of its activities crosses the *de minimis* thresholds, then the person would have to register as a security-based swap dealer and become subject to Title VII security-based swap dealer requirements. A person that chooses to comply in this manner would experience no incremental economic effects under the exception as compared to the baseline.

The second option would be to rely on the exception afforded by the amendment. Under the amendment, a person could register one entity as a security-based swap dealer or broker-dealer<sup>454</sup> to arrange, negotiate, or execute transactions with non-U.S. counterparties on its behalf using personnel located in a U.S. branch or office. Doing so could allow it to avoid the direct regulation of itself (or multiple affiliated entities) as a security-based swap dealer. A person that chooses to use this exception and incur the associated costs to meet the conditions of this exception, detailed below, likely would not incur assessment costs with respect to

<sup>445</sup> See European Commission email, summarized in Table 4 below and showing that 6 market participants estimated that the proposal may reduce the scope of associated persons within the statutory prohibition by an average of approximately 54%, with a range of estimates between 20% and 85%.

<sup>446</sup> See European Commission email.

<sup>447</sup> Range of associated persons if global SBS associated persons are taken into account, with broad definition and accounting for back office.

<sup>448</sup> Remaining range of associated persons after accounting for potential reduction of this number

when removing personnel with no U.S. person contacts.

<sup>449</sup> This figure represents an estimate of "only those associated persons authorized to communicate directly with U.S. persons."

<sup>450</sup> See European Commission email. Where a market participant provided a range, the percentage reduction was calculated using a midpoint of that range. When a market participant provided an estimate using "over," the percentage reduction assumed the figure was exactly as reported, which may under-estimate the magnitude of the reduction relative to baseline.

<sup>451</sup> See Rule of Practice 194 Adopting Release, 84 FR at 4925.

<sup>452</sup> This estimate is calculated as follows:  $5 \times 0.2 = 1$  application;  $5 \times 0.85 = 4.25$  or, approximately, 4 applications.

<sup>453</sup> See Part II.A, *supra*.

<sup>454</sup> Registration may not be required if, as discussed in Part VI.A.7, *supra*, persons who may take advantage of this exception already have affiliates that are registered and choose to use these registered entities to take advantage of the exception. See also Part VI.B.1.a, *infra*.

security-based swap transactions with non-U.S. counterparties that are arranged, negotiated, or executed by personnel located in the United States.

As discussed above, the Commission believes that up to 24<sup>455</sup> persons potentially may use the exception to the extent that the compliance costs associated with the exception are lower than the compliance costs in the absence of the exception.

#### 1. Costs and Benefits of the Amendment

The Commission believes that the amendment would provide increased flexibility to security-based swap market participants to comply with the Title VII framework while preserving their existing business practices. This could reduce their compliance burdens, while supporting the Title VII regime's benefit of mitigating risks in foreign security-based swap markets that may flow into U.S. financial markets through liquidity spillovers. The Commission also believes that the amendments could reduce market fragmentation and associated distortions. At the same time, and as detailed later in this section, the Commission acknowledges that the amendment potentially limits certain other programmatic benefits of the Title VII regime by excusing security-based swap market participants that elect to use the exception from some of the Title VII requirements that would otherwise apply to their activity. The Commission believes that the amendment will result in compliance costs for persons that elect to use the exception, as described below. However, the Commission expects that persons will elect to incur those costs only where it would be less costly than either complying with the Title VII framework or restructuring to avoid using U.S. personnel to arrange, negotiate, or execute transactions with non-U.S. counterparties.

#### (a) Costs and Benefits for Persons That May Use the Amendment

The primary benefit of the amendment is that it would permit a person further flexibility to opt into a Title VII compliance framework that is compatible with its existing business practices. While the registered U.S. person would be the entity adhering to most of the conditions set forth in the amendment and the non-U.S. person would be responsible for complying with some of the other conditions,<sup>456</sup> for the purposes of this analysis, the Commission assumes that the costs of complying with these conditions will be

passed on to the non-U.S.-person affiliate. In the absence of the amendment, a non-U.S. person could incur the cost of registering as a security-based swap dealer, and a financial group may incur the cost of registering at least one security-based swap dealer<sup>457</sup> due to the "arranged, negotiated, or executed" counting test. The non-U.S. person or group accordingly would incur the cost necessary for compliance with the full set of security-based swap dealer requirements by one or more registered security-based swap dealers. These burdens, contingent on exceeding the *de minimis* threshold, are in addition to the assessment costs that the non-U.S. person would incur to identify and count relevant market-facing activity toward the *de minimis* threshold.

As discussed in the ANE Adopting Release, such a non-U.S. person could respond to these costs by restructuring its security-based swap business to avoid using U.S. personnel to arrange, negotiate, or execute transactions with non-U.S. counterparties. Such a strategy would allow the non-U.S. person to avoid counting transactions between the non-U.S. person and its non-U.S. counterparties toward the non-U.S. person's *de minimis* threshold. In addition to reducing the likelihood of incurring the programmatic costs associated with the full set of security-based swap dealer requirements under Title VII, this response to current requirements could reduce the assessment costs associated with counting transactions toward the *de minimis* threshold and fully abrogate the need to identify transactions with non-U.S. counterparties that involve U.S. personnel.<sup>458</sup>

<sup>457</sup> The available data limit the Commission's ability to discern the multiple different legal entities each of which engages in security-based swap market-facing activity at levels above the *de minimis* thresholds because the way in which non-U.S. persons organize their dealing business may not align with the way their transaction volumes are accounted for in TIW. In particular, it is possible that some of the 10 non-U.S. persons identified in the TIW data as potential registrants aggregate transaction volumes of multiple non-U.S.-person dealers. In such cases, the exclusion of transactions between these non-U.S.-person dealers and non-U.S. counterparties from the *de minimis* calculations may result in multiple non-U.S.-person dealers no longer meeting the *de minimis* threshold.

<sup>458</sup> In 2016, the Commission estimated a cost of \$410,000 per entity to establish systems to identify market-facing activity arranged, negotiated, or executed using U.S. personnel and \$6,500 per entity per year for training, compliance and verification costs. See ANE Adopting Release, 81 FR at 8627. Adjusted for inflation, these amounts are respectively approximately \$443,292 and \$7,028 in 2019 dollars. Unless otherwise stated, cost estimates in Part VI of this release are adjusted for CPI inflation using data from the Bureau of Labor Statistics through June 2019, where applicable.

However, the Commission also noted in the ANE Adopting Release that restructuring is itself costly. To reduce the costs of assessment and potential dealer registration, a non-U.S. person may need to incur costs to ensure that U.S. personnel are not involved in arranging, negotiating, or executing transactions with non-U.S. counterparties. The Commission was able to quantify some, but not all of the costs of restructuring in the ANE Adopting Release.<sup>459</sup> As discussed above in Part VI.A.2.d, non-U.S. persons may make their location decisions based on business considerations such as maintaining 24-hour operations or the value of local market expertise. Thus, restructuring business lines or relocating personnel (or the activities performed by U.S. personnel) to avoid the United States could result in less efficient operations for non-U.S. persons active in the security-based swap market.

The exception would benefit non-U.S. persons by offering them an alternative to costly relocation or restructuring that would still permit them to avoid some of the costs associated with assessing their market-facing activity while also reducing the likelihood that their market-facing activity crosses the *de minimis* threshold. As discussed in detail below, the availability of the exception would be conditioned on the use of a registered entity and compliance with certain Title VII requirements designed to protect counterparties but not all Title VII requirements. To the extent that the costs of compliance with these conditions are lower than the compliance costs in the absence of the amendment and the costs of business restructuring, the exception could reduce the regulatory cost burden for the non-U.S. person or group.

The Commission recognizes that U.S.-based dealing entities may use the exception by booking transactions with non-U.S. counterparties into non-U.S. affiliates, thereby avoiding the application of the full set of security-based swap dealer requirements to those transactions and the associated security-

<sup>459</sup> In 2016, the Commission estimated it would cost approximately \$28,300 per entity to establish policies and procedures to restrict communication between personnel located in the United States employed by non-U.S. persons or their agents, and other personnel involved in market-facing activity. See ANE Adopting Release, 81 FR at 8628. Adjusted for inflation, this is approximately \$30,598. The foregoing is one of the ways in which a non-U.S. person might choose to restructure its business activities. Other restructuring methods, such as the relocation of U.S. personnel to locations outside the United States, potentially would be more costly.

<sup>455</sup> See Part VI.A.7, *supra*.

<sup>456</sup> See, e.g., Exchange Act Rule 3a71-3(d)(1)(iii)(A).

based swaps.<sup>460</sup> As discussed further in Part VI.B.1.b below, U.S.-based dealing entities that use the conditional exception in this manner may benefit by incurring lower compliance costs when providing liquidity to non-U.S. counterparties.

The Commission's designation of a listed jurisdiction by order could signal to non-U.S. counterparties that a non-U.S. person was subject to a regulatory regime that, at a minimum, is consistent with the public interest in terms of financial responsibility requirements, the jurisdiction's supervisory compliance program, the enforcement authority in connection with those requirements, and other factors the Commission may consider. This process potentially provides a certification

benefit to non-U.S. persons availing themselves of the exception by demonstrating to non-U.S. counterparties the applicability of regulatory requirements that would be in the public interest.

Table 3 summarizes the quantifiable costs the Commission estimates non-U.S. persons could incur as a result of the conditions associated with the exception. The per-entity cost estimates assume the de novo formation of a security-based swap dealer or broker-dealer. The Commission expects that these are likely upper bounds for per-entity costs for two reasons. First, non-U.S. persons may already be regulated by jurisdictions with similar requirements and, as a consequence of foreign regulatory requirements, may

already have established infrastructure, policies, and procedures that would facilitate meeting the conditions of the exception. For example, a non-U.S. person regulated by a jurisdiction with similar trade acknowledgment and verification requirements would likely already have an order management system in place capable of complying with Rule 15Fi-2, making development of a novel system for the purpose of taking advantage of the exception unnecessary. Second, non-U.S. persons that already have an affiliated registered security-based swap dealer or registered broker-dealer likely would use their existing registered affiliates to rely on the exception rather than register new entities.

TABLE 3—ESTIMATES OF QUANTIFIABLE COSTS ASSOCIATED WITH AMENDMENT TO RULE 3a71-3<sup>461</sup>

	Initial costs		Ongoing costs	
	Per entity	Aggregate	Per entity	Aggregate
<i>Registered entity:</i>				
Security-based swap dealer registration .....	\$530,991 .....	\$12,743,784 .....	\$2,797	\$67,128
Security-based swap dealer capital requirement .....			3,000,000	72,000,000
Broker-dealer registration .....	\$301,400 .....	\$7,233,600 .....	54,800	1,315,200
Broker-dealer capital requirement .....			3,000,000	72,000,000
Risk management control systems .....	\$525,333 .....	\$12,607,992 .....	71,000	1,704,000
Applicable SBSD requirements .....	\$2,107,341 .....	\$50,576,184 .....	520,735	12,497,640
<i>Recordkeeping:</i>				
• If registered entity is a registered security-based swap dealer and registered broker-dealer or registered entity is a stand-alone registered broker-dealer ..	\$530,935 .....	\$12,742,440 .....	101,353	2,432,472
• If registered entity is a stand-alone registered SBSD ..	\$243,376 .....	\$5,841,024 .....	61,140	1,467,360
• If registered entity is a bank registered SBSD .....	\$187,388 .....	\$4,497,312 .....	44,405	1,065,720
Trading relationship documentation .....	\$3,150 .....	\$75,600 .....	3,692	88,608
Consent to service of process .....	\$423 .....	\$10,152 .....		
Development of policies and procedures for threshold compliance documentation .....	\$4,230 .....	\$101,520 .....		
Receipt and maintenance of compliance documentation .....			21,996	527,904
Notice by registered entity .....	\$212 .....	\$5,088 .....		
Analysis of inter-dealer activity .....	\$16,320 .....	\$391,680 .....	18,190	436,560
<i>Non-U.S. entity:</i>				
Trading relationship documentation .....	\$3,150 .....	\$75,600 .....	7,384	177,216
Consent to service of process .....	\$423 .....	\$10,152 .....		
Disclosure of limited Title VII applicability .....	\$30,598 and 100 hours .....	\$734,352 and 2,400 hours .....		
"Listed jurisdiction" applications .....	\$119,364 .....	\$358,092 .....		
Development of policies and procedures for threshold compliance documentation .....	\$4,230 .....	\$101,520 .....		
Creation and conveyance of compliance documentation .....			43,992	1,055,808

<sup>460</sup> See Parts II.C and VI.A.7, *supra*.

<sup>461</sup> Certain cost estimates presented in this section differ from those presented in the Proposing Release (see Proposing Release, 84 FR at 24255-61). There are a number of reasons for such differences. First, the Commission now adjusts for inflation through June 2019, whereas in the Proposing Release, the Commission adjusted for inflation through the end of 2018 (see note 458, *supra*). Second, the

Commission now uses data through the end of 2018 to estimate the capital requirement for the registered entity, whereas in the Proposing Release, the Commission used data through the first quarter of 2018. Third, the Commission has revised the cost estimates associated with the suitability condition to reflect (a) the number of non-U.S. counterparties presented in Part VII.A.4 note 663, *infra*, and (b) modifications to the suitability condition as

discussed in Part II.C.2, *supra*, and Part VII.A.4, *infra*. Fourth, the Commission has removed the costs associated with the proposed portfolio reconciliation requirement, which the Commission is not adopting. Fifth, the Commission has revised the cost associated with the capital requirement for the registered entity if it is a registered broker, in light of modifications discussed in Part II.C.1, *supra*.



If a non-U.S. person or its affiliated group seeks to rely on the exception using a registered security-based swap dealer, that person or its affiliated group would incur the cost of registering one U.S.-based entity as a security-based swap dealer (if there otherwise is not an affiliated security-based swap dealer present).<sup>462</sup> The Commission estimates per entity initial costs of registering a security-based swap dealer of approximately \$530,991.<sup>463</sup> In addition, the non-U.S. person or its affiliated group would incur ongoing costs associated with its registered security-based swap dealer of approximately \$2,797.<sup>464</sup> Based on the Commission's estimate that up to 24<sup>465</sup> persons might avail themselves of the exception, the aggregate initial costs associated with registering security-based swap dealers under the exception would be approximately \$12,743,784 and the aggregate ongoing costs would be approximately \$67,128.<sup>466</sup> The U.S. person affiliate of such a non-U.S. person or affiliated group would also be

required to meet minimum capital requirements as a registered security-based swap dealer.<sup>467</sup> At a minimum, the Commission estimates the ongoing cost of this capital to be approximately \$3 million<sup>468</sup> per entity and \$72 million in aggregate.<sup>469</sup> To the extent that this capital is held in liquid assets<sup>470</sup> that generate a positive return to the registered security-based swap dealer, that positive return could be used to offset, at least in part, the ongoing cost of capital.

If a non-U.S. person or its affiliated group seeks to rely on the exception

using a registered broker-dealer, that person or its affiliated group would incur the cost of registering one entity as a broker-dealer (if there otherwise is not an affiliated broker-dealer present). The Commission estimates the per entity initial costs of registering a broker-dealer to be approximately \$301,400,<sup>471</sup> and estimates the per entity ongoing costs of meeting registration requirements as a broker-dealer to be approximately \$54,800<sup>472</sup> per year. Based on the Commission's estimate that up to 24<sup>473</sup> persons might avail themselves of the exception and assuming that these persons choose to do so by using registered broker-dealers, the Commission estimates the aggregate initial costs of broker-dealer registration to be \$7,233,600<sup>474</sup> and the aggregate ongoing costs of meeting broker-dealer registration requirements to be \$1,315,200<sup>475</sup> per year. Non-U.S. persons meeting the conditions of the exception by using a registered broker-dealer would additionally incur the cost of complying with applicable requirements associated with the registered broker-dealer status, including maintaining a minimum level of net capital. The Commission estimates the ongoing cost of this capital to be approximately \$3 million<sup>476</sup> per

<sup>461</sup> Certain cost estimates presented in this section differ from those presented in the Proposing Release (see Proposing Release, 84 FR at 24255–61). There are a number of reasons for such differences. First, the Commission now adjusts for inflation through June 2019, whereas in the Proposing Release, the Commission adjusted for inflation through the end of 2018 (see note 458, *supra*). Second, the Commission now uses data through the end of 2018 to estimate the capital requirement for the registered entity, whereas in the Proposing Release, the Commission used data through the first quarter of 2018. Third, the Commission has revised the cost estimates associated with the suitability condition to reflect (a) the number of non-U.S. counterparties presented in Part VII.A.4 note 663, *infra*, and (b) modifications to the suitability condition as discussed in Part II.C.2, *supra*, and Part VII.A.4, *infra*. Fourth, the Commission has removed the costs associated with the proposed portfolio reconciliation requirement, which the Commission is not adopting. Fifth, the Commission has revised the cost associated with the capital requirement for the registered entity if it is a registered broker, in light of modifications discussed in Part II.C.1, *supra*.

<sup>462</sup> This is a Title VII programmatic cost and is in addition to other Title VII programmatic costs discussed in Part VI.B.1.b, *infra*.

<sup>463</sup> This estimate incorporates quantifiable initial costs presented in the Registration Adopting Release, 80 FR at 48990–95 & 49005–06, adjusted for inflation. Specifically, per entity initial costs in 2019 dollars are estimated as \$13,027 (filing Form SBSE) + \$13,289 (senior officer certification) + \$449,700 (associated natural person certifications) + \$27,110 (associated entity person certifications) + \$27,865 (initial filing of Schedule F) = \$530,991.

<sup>464</sup> This estimate incorporates quantifiable annual costs presented in the Registration Adopting Release, 80 FR at 48990–95 & 49005–06, adjusted for inflation. Specifically, per entity ongoing costs in 2019 dollars are estimated as \$931 (amending Form SBSE) + \$1,505 (amending Schedule F) + \$51 (retaining signature pages) + \$310 (filing withdrawal form) = \$2,797.

<sup>465</sup> See Part VI.A.7, *supra*.

<sup>466</sup> Aggregate initial costs calculated as  $24 \times \$530,991 = \$12,743,784$ . Aggregate ongoing costs calculated as  $24 \times \$2,797 = \$67,128$ .

<sup>467</sup> A registered non-bank security-based swap dealer may be subject to minimum fixed-dollar capital requirements of \$20 million or \$1 billion in net capital and \$100 million or \$5 billion in tentative net capital, depending in part on whether it is a stand-alone security-based swap dealer or a security-based swap dealer that is dually registered as a broker-dealer, and on whether it uses models to compute deductions for market and credit risk. See Capital, Margin, and Segregation Adopting Release, 84 FR at 43874–76. Registered security-based swap dealers that have a prudential regulator must comply with capital requirements that the prudential regulators have prescribed. See Margin and Capital Requirements for Covered Swap Entities, 80 FR 74840 (Nov. 30, 2015) (adopting capital requirements for bank security-based swap dealers).

<sup>468</sup> This estimation assumes that the registered entity relies on the limited exemption from broker registration, does not use models to compute deductions for market or credit risk, and thus must maintain a minimum net capital of \$20 million. See Part II.C, *supra*, and Capital, Margin, and Segregation Adopting Release, 84 FR at 43875. The Commission estimated the cost of capital in two ways. First, the time series of average return on equity for all U.S. banks between the fourth quarter 1983 and the fourth quarter 2018 (see Federal Financial Institutions Examination Council (US), Return on Average Equity for all U.S. Banks [USROE], retrieved from FRED, Federal Reserve Bank of St. Louis on July 26, 2019, available at <https://fred.stlouisfed.org/series/USROE>), are averaged to arrive at an estimate of 11.28%. The cost of capital is calculated as  $11.28\% \times \$20 \text{ million} = \$2.256 \text{ million}$  or approximately \$2.3 million. The Commission believes that use of the historical return on equity for U.S. banks adequately captures the cost of capital because of the 12 persons that were identified in the 2017 TIW data as persons that potentially may use the exception, eight are banks and three have bank affiliates. See Part VI.A.7, *supra*. To the extent that this approach does not adequately capture the cost of capital of persons that are not banks or have no bank affiliates, the Commission supplements the estimation by also using the annual stock returns on financial stocks to calculate the cost of capital. With this second approach, the annual stock returns on a value-weighted portfolio of financial stocks from 1983 to 2018 (see Professor Ken French's website, available at [http://mba.tuck.dartmouth.edu/pages/faculty/ken\\_french/data\\_library.html](http://mba.tuck.dartmouth.edu/pages/faculty/ken_french/data_library.html) and accessed on July 26, 2019) are averaged to arrive at an estimate of 16.05%. The cost of capital is calculated as  $16.05\% \times \$20 \text{ million} = \$3.21 \text{ million}$  or approximately \$3.2 million. The final estimate of the cost of capital is the average of \$2.3 million and \$3.2 million =  $(2.3 + 3.2)/2 = \$2.75 \text{ million}$  or approximately \$3 million.

<sup>469</sup> Aggregate costs calculated as  $\$3 \text{ million} \times 24 \text{ entities} = \$72 \text{ million}$ .

<sup>470</sup> See Capital, Margin, and Segregation Adopting Release, 84 FR at 43879.

<sup>471</sup> The Commission previously estimated that an entity would incur costs of \$275,000 to register as a broker-dealer and become a member of a national securities association. See Crowdfunding, Exchange Act Release No. 76324 (Oct. 30, 2015), 80 FR 71388, 71509 (Nov. 16, 2015) (“Regulation Crowdfunding Adopting Release”). Adjusted for inflation, these costs are \$301,400 in 2019 dollars.

<sup>472</sup> The Commission previously estimated that an entity would incur ongoing annual costs of \$50,000 to maintain broker-dealer registration and membership of a national securities association. See Regulation Crowdfunding Adopting Release, 80 FR at 71509. Adjusted for inflation, these costs are \$54,800 in 2019 dollars. The estimation of ongoing annual costs is based on the assumption that the entity would use existing staff to perform the functions of the registered broker-dealer and would not incur incremental costs to hire new staff. To the extent that the entity chooses to hire new staff, the ongoing annual costs may be higher.

<sup>473</sup> See Part VI.A.7, *supra*.

<sup>474</sup> Aggregate broker-dealer registration costs calculated as  $\$301,400 \times 24 \text{ entities} = \$7,233,600$ .

<sup>475</sup> Aggregate ongoing costs of meeting broker-dealer registration requirements calculated as  $= \$54,800 \times 24 \text{ entities} = \$1,315,200$ .

<sup>476</sup> This estimation assumes that the registered entity does not use models to compute deductions for market or credit risk and thus must maintain a minimum net capital of \$20 million (see Part II.C, *supra*). The Commission believes that the methodology for estimating the cost of capital of a registered security-based swap dealer is also appropriate for estimating the cost of capital of a registered broker-dealer (see note 468, *supra*). Using the historical return on equity for all U.S. banks, the Commission calculated the cost of capital as  $11.28\% \times \$20 \text{ million} = \$2.256 \text{ million}$  or approximately \$2.3 million. The Commission believes that use of the historical return on equity

Continued

entity. If the up to 24 persons that might use the exception choose to do so by using registered broker-dealers, the estimated aggregate ongoing cost of capital is approximately \$72 million.<sup>477</sup> To the extent that this capital is held in liquid assets<sup>478</sup> that generate a positive return to the registered broker-dealer, that positive return would offset, at least in part, the ongoing cost of capital.

To the extent that a non-U.S. person or its affiliated group seeks to rely on the exception by using a registered broker-dealer that is not approved to use models and is not dually registered as a security-based swap dealer or an OTC derivatives dealer, such a non-U.S. person or its affiliated group would incur costs to establish and maintain risk management control systems as if the registered entity also were a security-based swap dealer.<sup>479</sup> The Commission estimates the per entity initial costs of such risk management control systems to be approximately \$525,333,<sup>480</sup> and estimates the per entity ongoing costs of such risk management control systems to be approximately \$71,000.<sup>481</sup> If the up to 24 persons that might use the exception choose to do so by using registered broker-dealers that are not approved to use models and are not dually registered

for U.S. banks adequately captures the cost of capital because of the 12 persons that were identified in the 2017 TIW data as persons that potentially may use the exception, eight are banks and three have bank affiliates. See Part VI.A.7, *supra*. To the extent that this approach does not adequately capture the cost of capital of persons that are not banks or have no bank affiliates, the Commission supplements the estimation by also using the annual stock returns on financial stocks to calculate the cost of capital. With this second approach, the Commission calculated the cost of capital as  $16.05\% \times \$20 \text{ million} = \$3.21 \text{ million}$  or approximately \$3.2 million. The final estimate of the cost of capital is the average of \$2.3 million and \$3.2 million =  $(2.3 + 3.2)/2 = \$2.75 \text{ million}$  or approximately \$3 million.

<sup>477</sup> Aggregate costs calculated as \$3 million  $\times$  24 entities = \$72 million.

<sup>478</sup> See Exchange Act Rule 15c3-1.

<sup>479</sup> See Section II.C.1.b, *supra*.

<sup>480</sup> Per entity initial costs =  $2,000/3 \text{ hours} \times \$423/\text{hour national hourly rate an attorney} + 2,000/3 \text{ hours} \times \$202/\text{hour national hourly rate for a risk management specialist} + 2,000/3 \text{ hours} \times \$139/\text{hour national hourly rate for an operations specialist} + \text{per entity hardware and software expenses of } \$16,000 = \$525,333.33$  or approximately \$525,333. See Capital, Margin, and Segregation Adopting Release, 84 FR at 43962 and Section VII.A.4.g, *infra*. The per hour figures for an attorney, a risk management specialist, and an operations specialist are from SIFMA's Management and Professional Earnings in the Securities Industry—2013, as modified by Commission staff to adjust for inflation and to account for an 1,800-hour work-year, and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

<sup>481</sup> Per entity ongoing costs =  $250 \text{ hours} \times \$202/\text{hour national hourly rate for a risk management specialist} + \text{per entity ongoing cost of } \$20,500 = \$71,000$ .

as security-based swap dealers or OTC derivatives dealers, the estimated aggregate initial costs and ongoing costs would be approximately \$12,607,992,<sup>482</sup> and \$1,704,000,<sup>483</sup> respectively.

To the extent that a non-U.S. person has an existing, registered broker-dealer affiliate,<sup>484</sup> and uses that affiliate to rely on the conditional exception, the non-U.S. person would not incur costs associated with registering a broker-dealer and the incremental compliance cost would be limited to costs associated with complying with the other conditions of the exception as discussed below.

In addition to registering either as security-based swap dealers or as broker-dealers, U.S. person affiliates of non-U.S. persons seeking to rely on the exception would be required to comply with applicable security-based swap dealer requirements, including those related to disclosures of risks, characteristics, incentives, and conflicts of interest, suitability,<sup>485</sup> communications, and trade acknowledgment and verification.<sup>486</sup> The Commission estimates initial costs associated with these requirements of up to approximately \$2,107,341 per entity,<sup>487</sup> or up to \$50,576,184 in

<sup>482</sup> Aggregate initial costs calculated as  $\$525,333 \times 24 \text{ entities} = \$12,607,992$ .

<sup>483</sup> Aggregate ongoing costs calculated as  $\$71,000 \times 24 \text{ entities} = \$1,704,000$ .

<sup>484</sup> Analyses of 2017 TIW data indicate that of the six non-U.S. persons that potentially may use the exception, four have majority-owned registered broker-dealer affiliates. See Part VI.A.7, *supra*.

<sup>485</sup> See note 461, *supra*, discussing, among other things, that the cost estimate associated with the suitability condition has been revised to reflect modifications to the suitability condition as discussed in Part II.C.2, *supra*, and Part VII.A.4, *infra*.

<sup>486</sup> See Exchange Act Rule 3a71-3(d)(1)(ii)(B). The costs of complying with applicable security-based swap dealer requirements are Title VII programmatic costs and are in addition to other Title VII programmatic costs discussed in Part VI.B.1.b, *infra*.

<sup>487</sup> This estimate incorporates quantifiable initial costs presented in the Business Conduct Adopting Release, 81 FR at 30092-93, 30111, 30117, 30126, and the Trade Acknowledgment and Verification Adopting Release, 81 FR at 39839, adjusted for inflation where applicable. Specifically, initial costs associated with disclosures, suitability, communications, and trade acknowledgment and verification in 2019 dollars are estimated as  $\$980,288 \text{ (disclosures)} + \$970,031 \text{ (suitability)} + \$18,034 \text{ (communications)} + \$138,988 \text{ (trade acknowledgment and verification)} = \$2,107,341$ . The cost associated with disclosures has been adjusted to account for the fact that the disclosures of clearing rights and daily mark are not part of paragraph (d)(1)(ii)(B)(1) of Exchange Act Rule 3a71-3.

As discussed above, the Commission assumes that the compliance costs incurred by the U.S. registered entity in connection with the amendment would be passed on to the non-U.S.-person affiliate. To the extent that the registered entity complies with the disclosure condition by delegating to the non-U.S.-person affiliate the tasks of delivering the

aggregate,<sup>488</sup> and ongoing costs associated with these requirements of approximately \$520,735 per entity,<sup>489</sup> or up to \$12,497,640 in aggregate.<sup>490</sup>

If the registered entity is a registered stand-alone security-based swap dealer, it also would be responsible for creating and maintaining books and records related to the transactions subject to the exception that are required, as applicable, by Exchange Act Rules 18a-5 and 18a-6, including any books and records requirements relating to the provisions specified in paragraph (d)(1)(iii)(B) of Rule 3a71-3. The Commission estimates the initial costs associated with Exchange Act Rules 18a-5 and 18a-6 to be approximately \$243,376 per entity,<sup>491</sup> or up to

required disclosures and creating (but not maintaining) books and records relating to those disclosures as required by Rule 3a71-3(d)(1)(iii)(B)(1) (see Part II.C.2, *supra*), the cost associated with the disclosure condition and the cost associated with Rule 3a71-3(d)(1)(iii)(B)(1) could be incurred directly, at least in part, by the non-U.S.-person affiliate. The Commission does not believe such delegation affects the estimation of the costs associated with the disclosure condition and Rule 3a71-3(d)(1)(iii)(B)(1). Further, to the extent that the registered entity complies with the trade acknowledgment and verification condition by delegating to the non-U.S. person-affiliate the tasks of delivering the required trade acknowledgment or verification and creating (but not maintaining) books and records relating to that trade acknowledgment or verification as required by Rule 3a71-3(d)(1)(iii)(B)(1) (see Part II.C.2, *supra*), the cost associated with the trade acknowledgment and verification condition and the cost associated with Rule 3a71-3(d)(1)(iii)(B)(1) could be incurred directly, at least in part, by the non-U.S.-person affiliate. The Commission does not believe such delegation affects the estimation of the costs associated with the trade acknowledgment and verification condition and Rule 3a71-3(d)(1)(iii)(B)(1).

In estimating the cost associated with the trade acknowledgment and verification condition, the Commission assumes that the registered entity relies on the exemption from Rule 10b-10 (see Exchange Act Rule 3a71-3(d)(5)) to the extent that the registered entity is a registered broker and Rule 10b-10 applies to the transaction that is subject to the exception. If such an entity does not rely on the exemption from Rule 10b-10, the cost associated with the trade acknowledgment and verification condition could be higher.

<sup>488</sup> Aggregate initial costs = Per entity initial costs of  $\$2,107,341 \times 24 \text{ entities} = \$50,576,184$ .

<sup>489</sup> This estimate incorporates quantifiable ongoing costs presented in the Business Conduct Adopting Release, 81 FR at 30092-93, 30111, 30126, and the Trade Acknowledgment and Verification Adopting Release, 81 FR at 39839, adjusted for inflation where applicable. Specifically, ongoing costs associated with disclosures, and trade acknowledgment and verification are estimated in 2019 dollars as  $\$424,407 \text{ (disclosures)} + \$96,328 \text{ (trade acknowledgment and verification)} = \$520,735$ . The cost associated with disclosures has been adjusted to account for the fact that the disclosures of clearing rights and daily mark are not part of paragraph (d)(1)(ii)(B)(1) of Rule 3a71-3.

<sup>490</sup> Aggregate ongoing costs = Per entity ongoing costs of  $\$520,735 \times 24 \text{ entities} = \$12,497,640$ .

<sup>491</sup> The per entity initial costs associated with Exchange Act Rule 18a-5 (assuming that the stand-

\$5,841,024 in aggregate,<sup>492</sup> and ongoing costs associated with these rules of approximately \$61,140 per entity,<sup>493</sup> or

alone registered security-based swap dealer does not have a prudential regulator and is not an ANC stand-alone registered security-based swap dealer) = 320 hours × \$315/hour national hourly rate for a compliance manager + per entity external costs of \$1,000 = \$101,800. *See* Recordkeeping and Reporting Adopting Release, 84 FR at 68609–11 for burden hours and external costs. The \$315 per hour figure for a compliance manager is from SIFMA's Management and Professional Earnings in the Securities Industry—2013, as modified by Commission staff to adjust for inflation and to account for an 1,800-hour work-year, and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

The per entity initial costs associated with Exchange Act Rule 18a–6 (assuming that the stand-alone registered security-based swap dealer does not have a prudential regulator and is not an ANC stand-alone registered security-based swap dealer) = 408 hours × \$347/hour national hourly rate for a senior database administrator = \$141,576. *See* Recordkeeping and Reporting Adopting Release, 84 FR at 68611–14 for burden hours. The \$347 per hour figure for a senior database administrator is from SIFMA's Management and Professional Earnings in the Securities Industry—2013, as modified by Commission staff to adjust for inflation and to account for an 1,800-hour work-year, and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

The per entity initial costs associated with Exchange Act Rules 18a–5 and 18a–6 = \$101,800 + 141,576 = \$243,376.

<sup>492</sup> Aggregate initial costs = Per entity initial costs of \$243,376 × 24 entities = \$5,841,024.

<sup>493</sup> The per entity ongoing costs associated with Exchange Act Rule 18a–5 (assuming that the stand-alone registered security-based swap dealer does not have a prudential regulator and is not an ANC stand-alone registered security-based swap dealer) = 400 hours × \$71/hour national hourly rate for a compliance clerk + per entity external costs of \$4,650 = \$33,050. *See* Recordkeeping and Reporting Adopting Release, 84 FR at 68609–11 for burden hours and external costs. The \$71 per hour figure for a compliance clerk is from SIFMA's Office Salaries in the Securities Industry (Oct. 2013), as modified by Commission staff to adjust for inflation

up to \$1,467,360 in aggregate.<sup>494</sup> The discussion in Part VI.A.7 above suggests that a number of the persons that may make use of the exception likely would be banks.<sup>495</sup> In light of this finding, the Commission also presents cost estimates associated with Exchange Act Rules 18a–5 and 18a–6 under the assumption that the registered security-based swap dealer is a bank registered security-based swap dealer. The Commission estimates the initial costs associated with these rules to be approximately \$187,388 per entity,<sup>496</sup> or up to

and to account for an 1,800-hour work-year, and multiplied by 2.93 to account for bonuses, firm size, employee benefits, and overhead.

The per entity ongoing costs associated with Exchange Act Rule 18a–6 (assuming that the stand-alone registered security-based swap dealer does not have a prudential regulator and is not an ANC stand-alone registered security-based swap dealer) = 310 hours × \$71/hour national hourly rate for a compliance clerk + per entity external costs of \$6,080 = \$28,090. *See* Recordkeeping and Reporting Adopting Release, 84 FR at 68611–14 for burden hours and external costs.

The per entity ongoing costs associated with Exchange Act Rules 18a–5 and 18a–6 = \$33,050 + 28,090 = \$61,140.

<sup>494</sup> Aggregate ongoing costs = Per entity ongoing costs of \$61,140 × 24 entities = \$1,467,360.

<sup>495</sup> *See* Part VI.A.7, *supra*, stating that of the 12 persons identified in 2017 TIW data as potential users of the exception, eight are banks.

<sup>496</sup> The per entity initial costs associated with Exchange Act Rule 18a–5 (assuming that the registered security-based swap dealer has a prudential regulator) = 260 hours × \$315/hour national hourly rate for a compliance manager = \$81,900. *See* Recordkeeping and Reporting Adopting Release, 84 FR at 68609–11 for burden hours. *See* note 491, *supra*, for a derivation of the national hourly rate for a compliance manager.

The per entity initial costs associated with Exchange Act Rule 18a–6 (assuming that the registered security-based swap dealer has a prudential regulator) = 304 hours × \$347/hour national hourly rate for a senior database

\$4,497,312 in aggregate,<sup>497</sup> and ongoing costs associated with these rules of approximately \$44,405 per entity,<sup>498</sup> or up to \$1,065,720 in aggregate.<sup>499</sup>

If the registered entity is a registered security-based swap dealer and a registered broker-dealer, or if the registered entity is a stand-alone registered broker-dealer, then it would need to comply with Exchange Act Rules 17a–3 and 17a–4, including any books and records requirements relating to the provisions specified in paragraph (d)(1)(iii)(B) of Rule 3a71–3. The Commission estimates the initial costs associated with Exchange Act Rules

administrator = \$105,488. *See* Recordkeeping and Reporting Adopting Release, 84 FR at 68611–14 for burden hours. *See* note 491, *supra*, for a derivation of the national hourly rate for a senior database administrator.

The per entity initial costs associated with Exchange Act Rules 18a–5 and 18a–6 = \$81,900 + \$105,488 = \$187,388.

<sup>497</sup> Aggregate initial costs = Per entity initial costs of \$187,388 × 24 entities = \$4,497,312.

<sup>498</sup> The per entity ongoing costs associated with Exchange Act Rule 18a–5 (assuming that the registered security-based swap dealer has a prudential regulator) = 325 hours × \$71/hour national hourly rate for a compliance clerk = \$23,075. *See* Recordkeeping and Reporting Adopting Release, 84 FR at 68609–11. *See* note 493, *supra*, for a derivation of the national hourly rate for a compliance clerk.

The per entity ongoing costs associated with Exchange Act Rule 18a–6 (assuming that the registered security-based swap dealer has a prudential regulator) = 230 hours × \$71/hour national hourly rate for a compliance clerk + per entity external costs of \$5,000 = \$21,330. *See* Recordkeeping and Reporting Adopting Release, 84 FR at 68611–14 for burden hours and external costs.

The per entity ongoing costs associated with Exchange Act Rules 18a–5 and 18a–6 = \$23,075 + 21,330 = \$44,405.

<sup>499</sup> Aggregate ongoing costs = Per entity ongoing costs of \$44,405 × 24 entities = \$1,065,720.

17a-3 and 17a-4 to be approximately \$530,935 per entity,<sup>500</sup> or up to \$12,742,440 in aggregate,<sup>501</sup> and ongoing costs associated with these rules of approximately \$101,353 per

<sup>500</sup> The Commission estimates these costs in two parts: (1) Costs associated with the SBS requirements of Exchange Act Rules 17a-3 and 17a-4, *i.e.*, recordkeeping requirements mandated under the Dodd-Frank Act with respect to broker-dealer SBSDs that were adopted in the Recordkeeping and Reporting Adopting Release and (2) costs associated with the non-SBS requirements of Exchange Act Rules 17a-3 and 17a-4.

The per entity initial costs associated with the SBS requirements of Exchange Act Rule 17a-3 (assuming the entity is not an ANC broker-dealer) = 150 hours × \$315/hour national hourly rate for a compliance manager = \$47,250. *See* Recordkeeping and Reporting Adopting Release, 84 FR at 68609–11. *See* note 491, *supra*, for a derivation of the national hourly rate for a compliance manager.

To estimate the per entity initial costs associated with the non-SBS requirements of Exchange Act Rule 17a-3, the Commission assumes these costs are proportional to the per entity ongoing costs associated with the non-SBS requirements of Exchange Act Rule 17a-3. Further, the Commission assumes that this proportion is equal to the proportion of per entity initial costs to per entity ongoing costs associated with the SBS requirements of Exchange Act Rule 17a-3. As discussed in note 502, *infra*, the Commission estimates the per entity ongoing costs associated with the SBS requirements of Exchange Act Rule 17a-3 as \$10,082. The proportion of per entity initial costs to per entity ongoing costs associated with the SBS requirements of Exchange Act Rule 17a-3 is \$47,250/\$10,082 or approximately 4.7. The per entity initial costs associated with the non-SBS requirements of Exchange Act Rule 17a-3 is estimated as 4.7 × \$59,186 (per entity ongoing costs associated with non-SBS requirements of Exchange Act Rule 17a-3, *see* note 502, *infra*) = \$278,174.20 or approximately \$278,174.

The per entity initial costs associated with the SBS requirements of Exchange Act Rule 17a-4 (assuming the entity is not an ANC broker-dealer) = 156 hours × \$347/hour national hourly rate for a senior database administrator = \$54,132. *See* Recordkeeping and Reporting Adopting Release, 84 FR at 68611–14. *See* note 491, *supra*, for a derivation of the national hourly rate for a senior database administrator.

To estimate the per entity initial costs associated with the non-SBS requirements of Exchange Act Rule 17a-4, the Commission assumes these costs are proportional to the per entity ongoing costs associated with non-SBS requirements of Exchange Act Rule 17a-4. Further, the Commission assumes that this proportion is equal to the proportion of per entity initial costs to per entity ongoing costs associated with SBS requirements of Exchange Act Rule 17a-4. As discussed in note 502, *infra*, the Commission estimates the per entity ongoing costs associated with the SBS requirements of Exchange Act Rule 17a-4 as \$8,432. The proportion of per entity initial costs to per entity ongoing costs associated with SBS requirements of Exchange Act Rule 17a-4 is \$54,132/\$8,432 or approximately 6.4. The per entity initial costs associated with non-SBS requirements of Exchange Act Rule 17a-4 is estimated as 6.4 × \$23,653 (per entity ongoing costs associated with non-SBS requirements of Exchange Act Rule 17a-4, *see* note 502, *infra*) = \$151,379.20.

The per entity initial costs associated with Exchange Act Rules 17a-3 and 17a-4 = \$47,250 + \$278,174.20 + \$54,132 + \$151,379.20 = \$530,935.40 or approximately \$530,935.

<sup>501</sup> Aggregate initial costs = Per entity initial costs of \$530,935 × 24 entities = \$12,742,440.

entity,<sup>502</sup> or up to \$2,432,472 in aggregate.<sup>503</sup>

The registered entity also must obtain from the non-U.S. person relying on the exception, and maintain for not less than three years following the “arranging, negotiating, or executing” activity pursuant to the exception, the first two years in an easily accessible place, documentation encompassing all terms governing the trading relationship between the non-U.S. person and its counterparty relating to the transactions subject to this exception, including, without limitation, terms addressing payment obligations, netting of payments, events of default or other termination events, calculation and netting of obligations upon termination, transfer of rights and obligations, allocation of any applicable regulatory reporting obligations, governing law, valuation, and dispute resolution.<sup>504</sup> The Commission believes that both the

<sup>502</sup> The Commission estimates these costs in two parts: (1) Costs associated with the SBS requirements of Exchange Act Rules 17a-3 and 17a-4, *i.e.*, recordkeeping requirements mandated under the Dodd-Frank Act with respect to broker-dealer SBSDs that were adopted in the Recordkeeping and Reporting Adopting Release and (2) costs associated with the non-SBS requirements of Exchange Act Rules 17a-3 and 17a-4.

The per entity ongoing costs associated with the non-SBS requirements of Exchange Act Rule 17a-3 = 673.40 hours × \$71/hour national hourly rate for a compliance clerk + per entity external costs of \$11,374.15 in 2019 dollars = \$59,185.55, or approximately \$59,186. Per entity ongoing burden hours = total burden hours of 2,763,612/4,104 broker-dealer respondents = 673.40 hours. *See* U.S. Securities and Exchange Commission, “Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 17a-3” (Mar. 9, 2017), available at <https://www.reginfo.gov/public/do/DownloadDocument?objectID=72125401>. *See* note 493, *supra*, for a derivation of the national hourly rate for a compliance clerk.

The per entity ongoing costs associated with the SBS requirements of Exchange Act Rule 17a-3 (assuming the entity is not an ANC broker-dealer) = 142 hours × \$71/hour national hourly rate for a compliance clerk = \$10,082 (*See* Recordkeeping and Reporting Adopting Release, 84 FR at 68609–11).

The per entity ongoing costs associated with the non-SBS requirements of Exchange Act Rule 17a-4 = 257 hours × \$71/hour national hourly rate for a compliance clerk + per entity external costs of \$5,406 in 2019 dollars = \$23,653. *See* U.S. Securities and Exchange Commission, “Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 17a-4” (Oct. 19, 2016), available at <https://www.reginfo.gov/public/do/DownloadDocument?objectID=68823501>.

The per entity ongoing costs associated with the SBS requirements of Exchange Act Rule 17a-4 (assuming the entity is not an ANC broker-dealer) = 72 hours × \$71/hour national hourly rate for a compliance clerk + per entity external costs of \$3,320 = \$8,432 (*See* Recordkeeping and Reporting Adopting Release, 84 FR at 68611–14).

The total per entity ongoing costs = \$59,186 + \$10,082 + \$23,653 + \$8,432 = \$101,353.

<sup>503</sup> Aggregate ongoing costs = Per entity ongoing costs of \$101,353 × 24 entities = \$2,432,472.

<sup>504</sup> *See* Exchange Act Rule 3a71-3(d)(1)(iii)(B)(2).

registered entity and its non-U.S. affiliate will incur costs to comply with this condition.<sup>505</sup> However as discussed above, the Commission believes that the costs incurred by the registered entity would be passed on to the non-U.S. affiliate. For registered entities, the Commission estimates the initial costs associated with this condition to be approximately \$3,150 per registered entity,<sup>506</sup> or up to \$75,600 in aggregate,<sup>507</sup> and ongoing costs associated with this condition of approximately \$3,692 per registered entity,<sup>508</sup> or up to \$88,608 in aggregate.<sup>509</sup> For non-U.S. entities, the Commission estimates the initial costs associated with this condition to be approximately \$3,150 per non-U.S. entity,<sup>510</sup> or up to \$75,600 in aggregate,<sup>511</sup> and ongoing costs associated with this condition of approximately \$7,384 per non-U.S. entity,<sup>512</sup> or up to \$177,216 in aggregate.<sup>513</sup>

The registered entity also would be responsible for obtaining from the non-U.S. person relying on this exception, and maintaining for not less than three years following the “arranging, negotiating, or executing” activity pursuant to the exception, the first two years in an easily accessible place, written consent to service of process for any civil action brought by or proceeding before the Commission, providing that process may be served on the non-U.S. person by service on the registered entity in the manner set forth in the registered entity’s current Form

<sup>505</sup> *See* Part VII.A.4.d, *infra*.

<sup>506</sup> As discussed in Part VII.A.4.d, *infra*, the condition imposes an initial burden of 20 hours. The Commission assumes that the burden will be allocated equally between the registered entity and the non-U.S. entity. Therefore, a registered entity will incur initial costs associated with a burden of 10 hours = 10 hours × \$315/hour national hourly rate for a compliance manager = \$3,150. *See* note 491, *supra*, for a derivation of the national hourly rate for a compliance manager.

<sup>507</sup> Aggregate initial costs = Per entity initial costs of \$3,150 × 24 entities = \$75,600.

<sup>508</sup> Per entity ongoing costs = 1 hour × 52 weeks × \$71/hour national hourly rate for a compliance clerk = \$3,692. *See* note 493, *supra*, for a derivation of the national hourly rate for a compliance clerk.

<sup>509</sup> Aggregate ongoing costs = Per entity ongoing costs of \$3,692 × 24 entities = \$88,608.

<sup>510</sup> As discussed in note 506, *supra*, a non-U.S. entity will incur initial costs associated with a burden of 10 hours = 10 hours × \$315/hour national hourly rate for a compliance manager = \$3,150. *See* note 491, *supra*, for a derivation of the national hourly rate for a compliance manager.

<sup>511</sup> Aggregate initial costs = Per entity initial costs of \$3,150 × 24 entities = \$75,600.

<sup>512</sup> Per entity ongoing costs = 2 hours × 52 weeks × \$71/hour national hourly rate for a compliance clerk = \$7,384. *See* note 493, *supra*, for a derivation of the national hourly rate for a compliance clerk.

<sup>513</sup> Aggregate ongoing costs = Per entity ongoing costs of \$7,384 × 24 entities = \$177,216.

BD, SBSE, SBSE-A, or SBSE-BD, as applicable.<sup>514</sup> The Commission believes that both the registered entity and its non-U.S. affiliate will incur one-time costs to comply with this condition.<sup>515</sup> For registered entities, the Commission estimates the one-time costs associated with this condition to be approximately \$423 per registered entity,<sup>516</sup> or up to \$10,152 in aggregate.<sup>517</sup> For non-U.S. entities, the Commission estimates the one-time costs associated with this condition to be approximately \$423 per non-U.S. entity,<sup>518</sup> or up to \$10,152 in aggregate.<sup>519</sup> To the extent both parties agree to use an industry-standard consent provision,<sup>520</sup> these costs may be limited.

Although costly, the Commission believes that the conditions associated with the exception afford appropriate counterparty protections under Title VII and the Commission has considered the benefits of these specific Rule provisions in prior Commission releases.<sup>521</sup> In the context of the exception, these conditions would benefit non-U.S. counterparties. Moreover, the registered entity would be required to notify non-U.S. counterparties, in connection with each transaction covered by the exception, that the non-U.S. person is not registered as a security-based swap dealer and that certain Exchange Act provisions or rules do not apply to the transaction.<sup>522</sup> The final rules require the registered entity to provide the notice contemporaneously with, and in the same manner as, the arranging, negotiating, or executing activity at issue. The final rules also provide that, during a period in which the

counterparty is not a customer<sup>523</sup> of the registered entity or a counterparty to a security-based swap with the registered entity, the notice need only be provided contemporaneously with, and in the same manner as, the first arranging, negotiating, or executing activity with that counterparty, rather than with each such activity during the period in which the counterparty is not such a customer or counterparty. Because this single notice is permitted only during a period in which the counterparty is not a customer of the registered entity or a counterparty to a security-based swap with the registered entity, the final rules would require the registered entity to resume providing the notice contemporaneously with, and in the same manner as, each arranging, negotiating, or executing activity at issue if the counterparty later becomes a customer of the registered entity or a counterparty to a security-based swap with the registered entity. The Commission believes that non-U.S. persons would incur an upfront cost of \$734,352 and 2,400 hours<sup>524</sup> to develop appropriate disclosures, but that non-U.S. persons using the exception would integrate these disclosures into existing trading systems so that the ongoing costs of delivering these disclosures would be insubstantial. Furthermore, disclosures are only required when the identity of the counterparty is known to the registered entity, so anonymous transactions would not be subject to this requirement.<sup>525</sup>

These required notices would benefit non-U.S. counterparties by informing them of the regulatory treatment of transactions under the exception. To the extent that non-U.S. counterparties value elements of the Title VII regulatory framework that do not apply to transactions under the exception, they may attempt to negotiate more favorable prices to compensate

themselves for the additional risks they may perceive. Alternatively, non-U.S. counterparties that prefer transactions fully covered by the Commission's security-based swap regulatory framework could search for a registered security-based swap dealer willing to transact with all Title VII protections in place.

The final rules include a cap of \$50 billion on the aggregate gross notional value of covered inter-dealer security-based swap positions that a registered entity may support on behalf of its non-U.S. person affiliates that choose to rely on the conditional exception. To comply with this provision, registered entities will develop policies and procedures for threshold compliance documentation at a one-time cost of \$4,230 per registered entity,<sup>526</sup> or \$101,520 in aggregate.<sup>527</sup> Registered entities will further incur ongoing costs associated with receipt and maintenance of compliance documentation received from non-U.S. persons.<sup>528</sup> The Commission estimates annual costs associated with receipt and maintenance of compliance documentation of \$21,996 per registered entity,<sup>529</sup> or \$527,904 in aggregate.<sup>530</sup> Use of the exception further requires the registered entity to file a notice with the Commission that the registered entity's associated persons will be used in connection with the exception. The Commission estimates that preparation and filing of such notice would entail initial costs of approximately \$212 per registered entity,<sup>531</sup> or \$5,088 in

<sup>526</sup> Per entity initial costs = 10 hour × \$423/hour for national hourly rate for an attorney = \$4,230. The hourly cost figure is based upon data from SIFMA's Management and Professional Earnings in the Securities Industry—2013 (modified by the Commission staff to adjust for inflation and to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead).

<sup>527</sup> Aggregate initial costs = Per entity initial costs of \$4,230 × 24 entities = \$101,520.

<sup>528</sup> The registered entities are required to maintain such documentation for not less than three years following the "arranging, negotiating, or executing" activity pursuant to the exception, the first two years in an easily accessible place. See Rule 3a71-3(d)(1)(iii)(B)(2).

<sup>529</sup> Per entity annual cost = 52 hour × \$423/hour for national hourly rate for an attorney = \$21,996. The hourly cost figure is based upon data from SIFMA's Management and Professional Earnings in the Securities Industry—2013 (modified by the Commission staff to adjust for inflation and to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead).

<sup>530</sup> Aggregate annual costs = Per entity annual costs of \$21,996 × 24 entities = \$527,904.

<sup>531</sup> Per entity initial costs = 0.5 hour × \$423/hour for national hourly rate for an attorney = \$211.50 or approximately \$212. The hourly cost figure is based upon data from SIFMA's Management and Professional Earnings in the Securities Industry—

Continued

<sup>514</sup> See Exchange Act Rule 3a71-3(d)(1)(iii)(B)(3).

<sup>515</sup> See Part VII.A.4.e, *infra*. The Commission assumes that the burden will be allocated equally between the registered entity and the non-U.S. entity. The burden associated with the registered entity's maintenance of records related to the consent to service condition are included in the Commission's estimate of the burden associated with the registered entity's maintenance of records related to the recordkeeping provisions.

<sup>516</sup> Per entity initial costs = 1 hour × \$423/hour for national hourly rate for an attorney = \$423. The hourly cost figure is based upon data from SIFMA's Management and Professional Earnings in the Securities Industry—2013 (modified by the Commission staff to adjust for inflation and to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead).

<sup>517</sup> Aggregate initial costs = Per entity initial costs of \$423 × 24 entities = \$10,152.

<sup>518</sup> See note 516, *supra*.

<sup>519</sup> See note 517, *supra*.

<sup>520</sup> See Part VII.A.4.e, *infra*.

<sup>521</sup> See Business Conduct Adopting Release; Trade Acknowledgment and Verification Adopting Release; and Recordkeeping and Reporting Adopting Release.

<sup>522</sup> See Exchange Act Rule 3a71-3(d)(1)(iv).

<sup>523</sup> The term "customer" is defined consistent with the definition of the term in Rule 15c3-3, the customer protection rule that applies to brokers and dealers. See Exchange Act Rule 15c3-3(a)(1).

<sup>524</sup> See Part VII.A.4.a and note 653, *infra*, stating that each non-U.S. person would spend 100 hours and incur approximate costs of \$30,598 in 2019 dollars to develop policies and procedures to help ensure that appropriate disclosures are provided. The aggregate upfront costs are = \$30,598 × 24 entities = \$734,352. The aggregate burden hours are = 100 × 24 entities = 2,400 hours. These cost estimates are based on the assumption that none of the non-U.S. persons would use the alternative means of satisfying the condition (*i.e.*, single disclosure) (see Part VII.A.4.a, *infra*). To the extent that non-U.S. persons rely on single disclosure as a means of satisfying the condition, the costs associated with the condition could be reduced.

<sup>525</sup> See Proposing Release, 84 FR at 24224 n.149, for circumstances in which the registered entity engaged would not know the identity of the counterparty.

aggregate.<sup>532</sup> Finally, registered entities that support ANE activity on behalf of non-U.S. person affiliates may choose to develop systems to determine whether their covered inter-dealer positions exceed the \$50 billion cap. The Commission estimates such systems or modifications to existing systems could cost a registered entity approximately \$16,320 in upfront costs,<sup>533</sup> or \$391,680 in aggregate.<sup>534</sup> Periodic assessment of positions against the \$50 billion cap could cost an additional \$18,190 per registered entity on an annual basis,<sup>535</sup> or \$436,560 in aggregate.<sup>536</sup>

As discussed in Part II above, non-U.S. persons operating in listed jurisdictions could rely on the conditional exception. By doing so, these non-U.S. persons may gain a competitive advantage over non-U.S. persons operating in unlisted jurisdictions. In particular, non-U.S. persons operating in listed jurisdictions and that rely on the exception may incur lower regulatory burdens<sup>537</sup> than non-U.S. persons operating in unlisted jurisdictions. This cost advantage may be limited if the Commission subsequently orders additional unlisted jurisdictions to be designated as listed

jurisdictions, and non-U.S. persons operating in these jurisdictions rely on the conditional exception following the designation. This cost advantage also may be limited if non-U.S. persons operating in unlisted jurisdictions could set up operations in a listed jurisdiction to rely on the exception.

For non-U.S. persons in jurisdictions that are not yet designated as listed jurisdictions by the Commission, an application for listed jurisdiction designation would be filed pursuant to Rule 0–13 and, like the exception, is purely voluntary. Thus, the Commission expects that, to the extent that market participants submit applications for designation of one or more listed jurisdictions, non-U.S. persons would do so only to the extent that they believe that compliance with each relevant jurisdiction's regulatory regime, in combination with the other conditions of the exception, was less burdensome than the alternatives of (i) incurring assessment costs related to *de minimis* calculations and potential compliance with the Title VII regulatory framework for dealers, and (ii) restructuring their security-based swap businesses to avoid arranging, negotiating, or executing transactions with non-U.S.

counterparties using personnel located in the United States. The Commission estimates that three non-U.S. persons that seek to rely on the exception would file listed jurisdiction applications.<sup>538</sup> The Commission estimates the costs associated with each application to be approximately \$119,364, or up to \$358,092 in aggregate.<sup>539</sup> Any costs incurred by a non-U.S. person in filing an application for a listed jurisdiction may be obviated in part by the provision that permits a foreign financial regulatory authority or authorities supervising such a non-U.S. person or its security-based swap activities to file such an application. Further, the non-U.S. persons (or their financial regulatory authorities) in those jurisdictions that are designated as listed jurisdictions by the Commission

may avoid the costs of filing an application.

Finally, a non-U.S. person that chooses to use the conditional exception would be required to develop policies and procedures, jointly with the registered entity that supports its ANE activity, for documentation to support compliance with the \$50 billion covered inter-dealer position threshold. The Commission estimates that a non-U.S. person, similar to a registered entity, would incur initial costs of \$4,230,<sup>540</sup> or \$101,520 in aggregate,<sup>541</sup> to develop these policies and procedures. Moreover, to maintain compliance with the cap on covered inter-dealer positions a non-U.S. person would incur ongoing costs to create compliance documentation and convey this documentation to the registered entity that supports its ANE activity. The Commission estimates annual costs of \$43,992 per non-U.S. person,<sup>542</sup> or \$1,055,808 in aggregate,<sup>543</sup> associated with creation and conveyance of compliance documentation.

#### (b) Title VII Programmatic Costs and Benefits

The exclusion of transactions that must be counted against the *de minimis* threshold will affect the set of registered security-based swap dealers subject to security-based swap dealer regulation and in turn determine the allocation and flow of programmatic costs and benefits arising from such regulation.

The Commission believes that Rule 3a71–3(d)(1)(v) would support the Title VII regime's programmatic benefit of mitigating risks in foreign security-based swap markets that may flow into U.S. financial markets through liquidity spillovers.<sup>544</sup> Specifically, Rule 3a71–

2013 (modified by the Commission staff to adjust for inflation and to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead). See Section VII.A.4.h, *infra*.

<sup>532</sup> Aggregate initial costs = Per entity initial costs of \$212 × 24 entities = \$5,088.

<sup>533</sup> Estimate based on prior Commission estimates of the costs of systems non-U.S. persons might implement to determine whether their dealing transactions exceed the *de minimis* thresholds, and adjusted for inflation to 2019 dollars. See Cross-Border Adopting Release, 79 FR at 47332. These initial systems costs would be lower for registered entities with systems already in place to assess whether their security-based swap transaction activity exceeds the *de minimis* threshold.

<sup>534</sup> Aggregate initial costs = Per entity initial costs of \$16,320 × 24 entities = \$391,680.

<sup>535</sup> Estimate based on prior Commission estimates of the costs of systems non-U.S. persons might implement to determine whether their dealing transactions exceed the *de minimis* thresholds, and adjusted for inflation to 2019 dollars. See Cross-Border Adopting Release, 79 FR at 47332. These ongoing systems costs would be lower for registered entities with systems already in place to assess whether their security-based swap transaction activity exceeds the *de minimis* threshold.

<sup>536</sup> Aggregate annual costs = Per entity annual costs of \$18,190 × 24 entities = \$436,560.

<sup>537</sup> These non-U.S. persons may incur lower regulatory burdens to the extent that they avoid the costs of assessing market-facing activity and the costs of compliance with conditions set forth under the exception are lower than the compliance costs in the absence of the exception and the costs of business restructuring. In contrast, non-U.S. persons in unlisted jurisdictions may have to incur the costs of assessing market-facing activity. Further, for these non-U.S. persons, the costs of complying with the full set of security-based swap dealer requirements and business restructuring may be higher than compliance costs associated with the exception.

<sup>538</sup> See Part VII.A.4.f, *infra*.

<sup>539</sup> The Commission assumes that the costs associated with filing an application for a qualified jurisdiction designation are the same as the costs associated with filing a substituted compliance request with respect to business conduct requirements. See Business Conduct Adopting Release, 81 FR at 30097, 30137, and Part VII.A.4.f, *infra*. The Commission estimates the per entity costs of filing an application in 2016 dollars as: \$30,400 (internal counsel) + \$80,000 (external counsel) = \$110,400. Adjusted for CPI inflation, the per entity costs of filing an application in 2019 dollars are = \$119,364. The aggregate costs of filing applications = Per entity costs of \$119,364 × 3 entities = \$358,092.

<sup>540</sup> Per entity initial costs = 10 hour × \$423/hour for national hourly rate for an attorney = \$4,230. The hourly cost figure is based upon data from SIFMA's Management and Professional Earnings in the Securities Industry—2013 (modified by the Commission staff to adjust for inflation and to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead).

<sup>541</sup> Aggregate initial costs = Per entity initial costs of \$4,230 × 24 entities = \$101,520.

<sup>542</sup> Per entity annual costs = 104 hour × \$423/hour for national hourly rate for an attorney = \$43,992. The hourly cost figure is based upon data from SIFMA's Management and Professional Earnings in the Securities Industry—2013 (modified by the Commission staff to adjust for inflation and to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead).

<sup>543</sup> Aggregate annual costs = Per entity annual costs of \$43,992 × 24 entities = \$1,055,808.

<sup>544</sup> As the Commission noted elsewhere, in a highly concentrated global security-based swap market, the failure of a key liquidity provider poses a particularly high risk of propagating liquidity shocks not only to its counterparties but to other participants, including other dealers. To the extent

3(d)(1)(v) would require a non-U.S. person relying on the exception to be subject to the margin and capital requirements of a listed jurisdiction when engaging in transactions subject to the exception. As discussed earlier,<sup>545</sup> the listed jurisdiction condition is intended to help avoid creating an incentive for dealers to book their transactions into entities that solely are subject to the regulation of jurisdictions that do not effectively require security-based swap dealers or comparable entities to meet certain financial responsibility standards. Absent this type of condition, non-U.S. persons that rely on the exception could gain a competitive advantage because they would be able to conduct security-based swap dealing activity in the United States without being subject to even minimal financial responsibility standards and incurring the associated compliance costs. Such non-U.S. persons potentially could provide liquidity to market participants at more favorable prices, but potentially also at greater risk, compared to registered security-based swap dealers. Generally, this condition would benefit non-U.S. counterparties. It provides them with assurances that the non-U.S. person has sufficient financial resources to engage in security-based swap activity and that the non-U.S. person's risk exposures to other counterparties are appropriately managed. This supports the Title VII regime's programmatic benefit of preventing risks in foreign security-based swap markets from flowing into U.S. financial markets through liquidity spillovers.

The Commission believes that another potential programmatic benefit of the amendment is to reduce market fragmentation and associated distortions. In the ANE Adopting Release, the Commission noted that the "arranged, negotiated, or executed" counting requirement may cause non-U.S. dealers to restructure their operations to avoid using U.S. personnel in order to avoid triggering security-based swap dealer obligations. Such restructuring may result in market fragmentation. Nevertheless, to the extent that the restructuring costs incurred by non-U.S. dealers offset the benefits from avoiding dealer registration, the likelihood or extent of market fragmentation and associated

distortions may be attenuated, but not eliminated.<sup>546</sup> The Commission believes that the amendment, by permitting a non-U.S. person further flexibility to opt into a Title VII compliance framework that is compatible with its existing business practices, could further reduce the incentives of non-U.S. persons to restructure and further reduce the likelihood or extent of market fragmentation and associated distortions.<sup>547</sup>

The above discussion notwithstanding, the Commission is mindful that the likelihood of market fragmentation and associated distortions might increase if U.S.-based dealing entities rely on the conditional exception by booking transactions with non-U.S. counterparties into non-U.S. affiliates, thereby avoiding the application of the full set of security-based swap dealer requirements to those transactions and the associated security-based swaps.<sup>548</sup> As discussed further below, U.S.-based dealing entities that use the conditional exception in this manner may incur lower compliance costs when providing liquidity to non-U.S. counterparties and may decide to limit their liquidity provision only to non-U.S. counterparties. To the extent that these U.S.-based dealing entities choose to provide liquidity only to non-U.S. counterparties, security-based swap liquidity may fragment into two pools: One pool that caters to U.S. counterparties and another pool that caters to non-U.S. counterparties.

The amendment could promote competition in the security-based swap market to the extent that competitive effects arise from differences between the full set of requirements for registered security-based swap dealers (that otherwise would apply to the non-U.S. entity) and the conditions applicable to the registered U.S. entity under the amendment. As discussed

more fully below,<sup>549</sup> a non-U.S.-person dealer that uses the exception may become more competitive in the market for liquidity provision because (a) the non-U.S.-person dealer may incur lower compliance costs when providing liquidity to non-U.S. counterparties and (b) non-U.S. counterparties may incur lower costs when transacting with the non-U.S.-person dealer. The set of dealing entities that benefit from such competitive effects might expand to the extent that U.S.-based dealing entities that are primarily or wholly responsible for managing interactions with non-U.S. counterparties may rely on the conditional exception by booking transactions into non-U.S. affiliates.<sup>550</sup> Nevertheless, this competitive effect may be attenuated by the condition that makes the exception available only to non-U.S. persons that are subject to the margin and capital requirements of a listed jurisdiction.

The amendment potentially could limit the programmatic benefits of Title VII regulation because the non-U.S. person taking advantage of the conditional exception would not be subject to the full suite of Title VII business conduct and financial responsibility requirements. This limitation of programmatic benefits might increase to the extent that U.S.-based dealing entities that primarily or wholly are responsible for managing interactions with non-U.S. counterparties may rely on the conditional exception by booking transactions into non-U.S. affiliates.<sup>551</sup> Because the non-U.S. person would not be subject to Title VII business conduct requirements, the associated Title VII counterparty protections would not apply to the non-U.S. person's communications with non-U.S. counterparties. The non-U.S. counterparties thus would not benefit from those protections in their dealings with the non-U.S. person relying on the exception, notwithstanding the U.S. arranging, negotiating, and executing activity that led to the transactions at issue.<sup>552</sup>

Similarly, Title VII financial responsibility requirements applicable to security-based swap dealers would not apply to the non-U.S. person, notwithstanding that the transactions would result from arranging, negotiating, and executing activity in the United States. The financial

<sup>546</sup> See ANE Adopting Release, 81 FR at 8630.

<sup>547</sup> One commenter perceived a tension between, on the one hand, the reduction in market fragmentation as a result of the amendment and, on the other hand, the exacerbation of market fragmentation if non-U.S. dealers limit themselves to trading with non-U.S. persons to avoid triggering security-based swap dealer obligations absent the rules adopted in the ANE Adopting Release (see ANE Adopting Release, 81 FR at 8610–11). See AFR letter at 4. The market fragmentation in both instances have different causes. The market fragmentation in the first instance stems from restructuring by non-U.S. dealers to avoid using U.S. personnel; the market fragmentation discussed in the ANE Adopting Release stems from the way non-U.S. dealers select their trading counterparties. The amendment addresses, among other things, market fragmentation that stems from restructuring by non-U.S. dealers.

<sup>548</sup> See Proposing Release, 84 FR at 24219, and Part VI.A.7, *supra*.

<sup>549</sup> See Part VI.B.2, *infra*.

<sup>550</sup> See Proposing Release, 84 FR at 24219.

<sup>551</sup> See *id.*

<sup>552</sup> The antifraud provisions of the federal securities laws and certain relevant Title VII requirements would continue to apply to the transactions. See note 24, *supra*.

that U.S. persons are significant participants in the market, the liquidity shock may propagate to these U.S. persons and from these U.S. persons to the U.S. financial system as a whole, even if the liquidity shock originates with the failure of a non-U.S. person liquidity provider. See ANE Adopting Release, 81 FR at 8611–12, 8630.

<sup>545</sup> See Part II.C.5, *supra*.



responsibility requirements serve to prevent the spread to U.S. financial markets of financial contagion that originates from the failure of one or more non-U.S. persons engaged in arranging, negotiating, and executing activity in the United States.<sup>553</sup> However, the fact that these requirements would not apply to non-U.S. persons taking advantage of the conditional exception could limit the Title VII regulatory regime's ability to protect U.S. financial markets from financial contagion. This concern would be mitigated by the condition that makes the exception available only to non-U.S. persons that are subject to the margin and capital requirements of a listed jurisdiction, which would afford the Commission flexibility to designate jurisdictions with appropriately robust financial responsibility requirements as listed jurisdictions.

Non-U.S. persons would face important limits on their ability to rely on the conditional exception. First, such non-U.S. persons could not rely on the exception if the gross notional value of covered inter-dealer security-based swap positions made in reliance on the conditional exception, aggregated across their non-U.S. affiliates, exceeded \$50 billion over the course of the immediately preceding 12 months. If this threshold were to be breached, the non-U.S. person relying on the exception must count against the *de minimis* thresholds all of its (and its non-U.S. person affiliates') covered inter-dealer security-based swap positions connected with dealing activity subject to the exception over the course of the immediately preceding 12 months, including any transactions below the \$50 billion limit.<sup>554</sup> This condition mitigates incentives for financial groups, including U.S. financial groups, to restructure their business to avoid the application of certain Title VII requirements by carrying out substantial amounts of transactions against other dealers using one or more unregistered foreign dealers. As a result, this condition will help preserve the programmatic effects of Title VII regulation of covered inter-dealer security-based swap activities while also reducing the potential that reliance on the exception by foreign dealers would distort markets by conferring competitive advantages on foreign dealers relative to U.S. dealers. Second, competitive disparities and

limits to the programmatic effects of Title VII may be more generally offset to the extent that non-U.S. counterparties value the protections afforded them by Title VII regulation and prefer to transact with dealing entities that are subject to the full scope of Title VII regulation, rather than with non-U.S. persons that rely on the conditional exception.

## 2. Effects on Efficiency, Competition, and Capital Formation

As discussed earlier, the amendment could reduce the regulatory burden for non-U.S. persons that engage in security-based swap arranging, negotiating, and executing activity with non-U.S. counterparties using affiliated U.S.-based personnel because these non-U.S. persons could avail themselves of an additional, potentially lower-cost, means of engaging in arranging, negotiating, and executing activity with non-U.S. counterparties.<sup>555</sup> To the extent that the regulatory burden for such non-U.S. persons is reduced as a result of the amendment, resources could be freed up for investing in profitable projects, which would promote investment efficiency and capital formation. In addition, a reduction in regulatory burden for such non-U.S. persons could allow these persons to operate their security-based swap dealing business more efficiently. To the extent that these non-U.S. persons carry out security-based swap dealing activity with counterparties around the world<sup>556</sup> and choose to pass on cost savings flowing from their improved efficiency in the form of lower prices for liquidity provision, counterparties around the world could benefit by being able to transact at lower costs. A reduction in regulatory burden associated with the amendment could lower entry barriers into the security-based swap market and increase the number of non-U.S.-person dealers that are willing to provide liquidity to non-U.S. counterparties using affiliated U.S.-based personnel. An increase in the number of such non-U.S.-person dealers may increase competition for liquidity provision to non-U.S. counterparties, which could lower transaction costs for these counterparties and improve their ability to hedge economic exposures. To the extent that non-U.S.-person dealers focus their market-making activities on non-U.S. counterparties and avoid U.S. counterparties, the competition for liquidity provision to U.S. counterparties may decline, which could increase transaction costs for U.S.

counterparties and impair their ability to hedge their economic exposures or to incur economic exposures. In addition, to the extent that increased transaction costs reduce the expected profits from trading on new information, market participants may be less willing to transact in the security-based swap market in response to new information. Such reduced participation in the security-based swap market might impede the incorporation of new information into security-based swap prices, reducing the informational efficiency of these markets.

The amendment might generate certain competitive effects due to gaps between the full set of requirements for registered security-based swap dealers and the conditions applicable to the registered entity of the non-U.S. person under the amendment,<sup>557</sup> though these effects will be tempered to the extent that the non-U.S.-person dealer passes on compliance costs incurred by its U.S. registered entity to the non-U.S. counterparty. First, under Rule 3a71-3(d)(1)(C), the exception would not be conditioned on the registered entity of the non-U.S. person dealer having to comply with requirements pertaining to ECP verification, daily mark disclosure, and "know your counterparty."<sup>558</sup> Thus, to the extent that the non-U.S. person adheres only to the provisions specifically required by the conditions set forth under the amendment, the non-U.S. person dealer could incur lower compliance costs in providing liquidity to non-U.S. counterparties than under current rules, relative to the baseline. In that case, the non-U.S. person-dealer might be able to lower the price at which it offers liquidity to a non-U.S. counterparty. However, under the exception the non-U.S. person must have a U.S. affiliate that is registered with the Commission. The extent to which the non-U.S. person dealer may offer a more competitive price would depend in part on whether the non-U.S. person dealer will pass on compliance costs incurred by its U.S. registered entity to the non-U.S. counterparty in the form of a higher price for providing liquidity to the non-U.S. counterparty. To the extent that the non-U.S. person-dealer offers liquidity to the non-U.S. counterparty at a price that fully

<sup>553</sup> See ANE Adopting Release, 81 FR at 8612.

<sup>554</sup> See Exchange Act Rule 3a71-3(d)(6)(ii)(B).

The *de minimis* thresholds to the "security-based swap dealer" definition appear in Rule 3a71-2(a)(1).

<sup>555</sup> See Part VI.B.1, *supra*.

<sup>556</sup> See Part VI.A.2.c, *supra*.

<sup>557</sup> As context, the use of the "arranged, negotiated, or executed" counting standard was intended in part to avoid allowing competitive disparities between registered security-based swap dealers and entities that otherwise could engage in security-based swap market-facing activity in the United States without having to register as security-based swap dealers. See Proposing Release, 84 FR at 24208-09.

<sup>558</sup> See Business Conduct Adopting Release, 81 FR at 29978.

recovers the compliance costs incurred by its U.S. registered entity, any price reduction that could be offered by the non-U.S.-person dealer might be limited.

Second, a non-U.S. counterparty may prefer to enter into a security-based swap transaction with a non-U.S.-person dealer that takes advantage of the conditional exception, rather than a U.S. registered security-based swap dealer, not only because the non-U.S. person dealer may offer more competitive prices, but also because the non-U.S. counterparty may itself avoid certain costs by transacting with a non-U.S. person dealer. For example, Title VII financial responsibility requirements applicable to security-based swap dealers would not apply to the non-U.S. person dealer under the amendment, although the non-U.S. person dealer would be subject to the margin and capital requirements of a listed jurisdiction. To the extent that a non-U.S. counterparty has already established with the non-U.S. person dealer the necessary margin agreement that is compliant with the margin requirements of the listed jurisdiction, the non-U.S. counterparty could avoid the additional costs of negotiating and adhering to a new margin agreement that is compliant with the Commission's Title VII margin requirements, if the non-U.S. counterparty transacts with the non-U.S. person dealer.

These competitive effects may create an incentive for entities that carry out their security-based swap dealing business in a U.S. person dealer with non-U.S. person counterparties to restructure a proportion of this business to be carried out in a non-U.S. person dealer affiliate. The extent to which such entities are willing or able to restructure would be limited. Market forces could limit incentives to restructure to the extent that non-U.S. counterparties value the protections afforded them by Title VII regulation and prefer to transact with dealing entities that are subject to the full scope of Title VII regulation, rather than with non-U.S. persons that rely on the conditional exception. Further, the \$50 billion aggregate notional value cap on covered inter-dealer security-based swap positions applied to registered entities that support non-U.S. person affiliates' reliance on the conditional exemption, limits non-U.S. persons' ability to restructure their security-based swap businesses.

### 3. Additional Alternatives Considered

In developing these amendments, the Commission considered a number of alternatives. This section outlines these

alternatives and discusses the potential economic effects of each.

#### (a) Proposed Alternative 1

The Commission is adopting Alternative 2 to the exception, which requires that the arranging, negotiating, and executing activity in the United States be performed by personnel associated either with a registered security-based swap dealer or with a registered broker—but is modifying elements of Alternative 2 from the proposal in response to concerns raised by commenters.<sup>559</sup>

As an alternative, the Commission could have adopted Alternative 1, which would have required the arranging, negotiating, and executing activity in the United States to be performed by personnel associated with registered security-based swap dealers.<sup>560</sup> Some commenters rejected Alternative 1 in favor of Alternative 2 because it provides more flexibility to market participants to utilize U.S. personnel associated with either a registered broker or a registered security-based swap dealer.<sup>561</sup> To the extent that market participants would choose not to rely on the exception if Alternative 1 were adopted, because of the absence of a registered broker option, Alternative 1 may have been less effective in supporting the use of “arranged, negotiated, or executed” criteria as part of *de minimis* counting, while avoiding negative consequences that otherwise may be associated with those criteria could be attenuated. In light of this concern, the Commission believes that the adopted approach is preferable to the alternative.

#### (b) Requiring the Registered Entity To Comply With ECP Verification and “Know Your Counterparty”

When identifying the security-based swap dealer requirements that are applicable to a registered entity for purposes of this rulemaking, the Commission considered requiring the registered entity to comply with ECP verification and “know your counterparty” requirements, along with other security-based swap dealer requirements, even if the registered entity is not a party to the resulting security-based swap. Although this alternative would lead to greater conformity with the full set of security-based swap dealer requirements, the provisions in question may require knowledge that may not be readily available to the registered entity when it

engages in limited arranging, negotiating, and executing activity in connection with the security-based swaps addressed by the exception. These operational difficulties may prevent the registered entity from complying with the provisions or may require the registered entity to incur costs to ensure compliance. The Commission estimates that, if included as part of the conditions of the exception, the ECP verification and know your counterparty requirements would impose initial costs of approximately \$3,006 per registered entity,<sup>562</sup> or \$72,144 in aggregate,<sup>563</sup> and ongoing costs of approximately \$94,497 per registered entity,<sup>564</sup> or \$2,267,928 in aggregate.<sup>565</sup> Further, the non-U.S. counterparties transacting with the non-U.S. persons making use of the exception that are not also participating in swap markets and relying on industry established verification of status protocol may incur initial costs associated with the verification of status requirement and related adherence letters.<sup>566</sup> The Commission estimates these aggregate initial costs at approximately \$473,598.<sup>567</sup> All non-U.S. counterparties (or their agents) transacting with the non-U.S. persons making use of the exception would also be required to collect and provide essential facts to the registered entities to comply with the “know your counterparty” obligations for an aggregate initial cost of approximately

<sup>562</sup> This estimate incorporates quantifiable initial costs presented in the Business Conduct Adopting Release, 81 FR at 30090–92, 30110, adjusted for inflation.

<sup>563</sup> Aggregate initial costs = Per entity initial costs of \$3,006 × 24 entities = \$72,144.

<sup>564</sup> This estimate incorporates quantifiable initial costs presented in the Business Conduct Adopting Release, 81 FR at 30090–92, 30110, adjusted for inflation.

<sup>565</sup> Aggregate initial costs = Per entity initial costs of \$94,497 × 24 entities = \$2,267,928.

<sup>566</sup> In the Business Conduct Adopting Release, the Commission assumed that counterparties that are swap market participants likely already adhere to the relevant protocol and would not have any start-up or ongoing burdens with respect to verification. See Business Conduct Adopting Release, 81 FR at 30091. The Commission continues to believe that this assumption is valid and thus, for purposes of this alternative, the Commission believes that only non-U.S. counterparties that are not swap market participants will incur verification-related costs. As discussed in Part VI.A.7, *supra*, the Commission estimates that up to 24 persons likely may use the exception, and that their registered entity affiliates may arrange, negotiate, or execute transactions with up to 1,614 non-U.S. counterparties, of which 498 do not participate in swap markets.

<sup>567</sup> This estimate incorporates quantifiable initial costs presented in the Business Conduct Adopting Release, 81 FR at 30090–92, 30110, adjusted for inflation. Per counterparty initial costs in 2019 dollars = \$951. Aggregate initial costs = Per entity initial costs of \$951 × 498 counterparties = \$473,598.

<sup>559</sup> See Exchange Act Rule 3a71–3(d)(1)(i)(A).

<sup>560</sup> See Proposing Release, 84 FR at 24291.

<sup>561</sup> See note 87, *supra*.

\$6,631,926.<sup>568</sup> To the extent that the knowledge needed to comply with these requirements may not be readily available to the registered entity and the registered entity has to expend additional resources to obtain that knowledge, the actual costs incurred by the registered entity to comply with these requirements may be higher. The Commission acknowledges that a non-U.S. person making use of the exception potentially could mitigate the compliance costs of the registered entity by transacting only with non-U.S. counterparties that are known ECPs to the registered entity. By doing so, the registered entity could avoid expending additional resources to learn about the non-U.S. counterparties' ECP status. However, as a result of this approach, the non-U.S. person may have to forgo transacting with new non-U.S. counterparties whose ECP status is not known to the registered entity. The non-U.S. person would thus have to balance the cost savings associated with transacting only with a set of known non-U.S. counterparties against the revenues that may be forgone by not transacting with new non-U.S. counterparties whose ECP status is unknown to the registered entity.

As another alternative, the Commission considered requiring compliance with the ECP verification and "know your counterparty" requirements with a one-time carve out when the non-U.S. counterparty is unknown to the registered entity and there is no basis to believe that the registered entity would have further interactions with that non-U.S. counterparty. Although such a carve out may reduce compliance costs arising from transactions that likely would pose the greatest operational difficulties in terms of obtaining knowledge needed for complying with the ECP verification and know your counterparty requirements, the Commission is also cognizant that the carve out may create new costs associated with assessing when the carve out would apply. The Commission is concerned that these new assessment costs may impose an additional burden on the registered entity and may offset any reduction in compliance costs associated with a one-time carve out. As with the previous alternative, a non-U.S. person making use of the exception potentially could mitigate the compliance costs of the

registered entity by transacting only with non-U.S. counterparties that are ECPs known to the registered entity. As discussed above, the non-U.S. person would thus have to balance the cost savings associated with this approach against the revenues that may be forgone by not transacting with new non-U.S. counterparties whose ECP status is unknown to the registered entity.

In light of these compliance challenges and the fact that the amendment does include conditions designed to impose a minimum standard of conduct upon security-based swap dealers in connection with their transaction-related activities, the Commission believes that the adopted approach is preferable to these alternatives.

#### (c) Requiring the Registered Entity To Comply With Daily Mark Disclosure

The Commission also considered requiring the registered entity to comply with daily mark disclosure, along with other security-based swap dealer requirements, even if the registered entity is not a party to the resulting security-based swap. Similar to the discussion of ECP verification and know your counterparty requirements above, this alternative would lead to greater conformity with the full set of security-based swap dealer requirements. However, it may require knowledge that may not be readily available to the registered entity when it engages in limited arranging, negotiating, and executing activity in connection with the security-based swaps addressed by the exception. Further, the daily mark disclosure is predicated on the existence of an ongoing relationship between the security-based swap dealer and the counterparty that may not be present in connection with the transactions at issue, and would be linked to risk management functions that are likely to be associated with the entity in which the resulting security-based swap position is located.<sup>569</sup> These operational difficulties may prevent the registered entity from complying with the daily mark disclosure requirement or may require the registered entity to incur an unreasonably high cost to ensure compliance. In light of these compliance challenges and the fact that the amendment does include conditions designed to impose a minimum standard of conduct upon security-based swap dealers in connection with their transaction-related activities, the Commission believes that the adopted

approach is preferable to this alternative.

#### (d) Requiring a Limited Disclosure of Incentives and Conflicts

As an alternative to the disclosure requirements set forth under Rule 3a71-3(d)(1)(ii)(B)(1), the Commission considered requiring the registered entity to disclose its own material incentives and conflicts of interest, but not requiring the registered entity to disclose the incentives and conflicts of interest of its non-U.S. affiliate. While this alternative might help to mitigate the costs associated with disclosing the incentives and conflicts of interest of the non-U.S. affiliate,<sup>570</sup> the benefits associated with such disclosures<sup>571</sup> may also decrease because non-U.S. counterparties would not know about the incentives and conflicts of interest of the non-U.S. affiliate prior to entering into security-based swaps with the non-U.S. affiliate. In light of this concern, the Commission believes that the adopted approach is preferable to this alternative.

#### (e) Requiring the Non-U.S. Person To Be Domiciled in a G-20 Jurisdiction or in a Jurisdiction Where the Non-U.S. Person Would Be Subject to Basel Capital Requirements

As alternatives to paragraph (d)(1)(v), the Commission considered a requirement that the non-U.S. person be domiciled in a G-20 jurisdiction or in a jurisdiction where the non-U.S. person would be subject to Basel capital requirements as commenters have suggested. While the Commission acknowledges that these alternatives are clearly defined and would provide certainty to market participants, the Commission believes these alternatives potentially could create opportunities for regulatory arbitrage whereby a non-U.S. person may relocate its operations to a jurisdiction that imposes lower financial responsibility standards. The non-U.S. person may thus enjoy a cost advantage relative to other dealers that operate under higher regulatory burdens, while not being subject to equally rigorous financial responsibility standards. Further, as discussed earlier,<sup>572</sup> the fact that a jurisdiction is a member of the G-20 or subscribes to Basel standards does not by itself provide assurance that the jurisdiction has implemented appropriate financial responsibility standards.

<sup>568</sup> This estimate incorporates quantifiable initial costs presented in the Business Conduct Adopting Release, 81 FR at 30090-92, 30110, adjusted for inflation. Per counterparty initial costs in 2019 dollars = \$4,109. Aggregate initial costs = Per entity initial costs of \$4,109 × 1,614 counterparties = \$6,631,926.

<sup>569</sup> See Proposing Release, 84 FR at 24223.

<sup>570</sup> See Business Conduct Adopting Release, 81 FR at 30112.

<sup>571</sup> See *id.* at 30111-12.

<sup>572</sup> See Part II.C.5, *supra*.

(f) Not Requiring Notification to Counterparties of the Non-U.S. Person

In identifying the conditions that would apply to the non-U.S. person, the Commission considered omitting the notification condition.<sup>573</sup> The omission of this notification condition may reduce cost and thus regulatory burden for the non-U.S. persons that rely on the exception.

However, the absence of this notification condition potentially could reinforce the competitive disparity between the non-U.S. persons that make use of the exception and registered security-based swap dealers that comply with the full set of Title VII security-based swap dealer requirements. As discussed above,<sup>574</sup> non-U.S. persons that avail themselves of the exception could bear lower costs compared to registered security-based swap dealers that have to comply with the full set of security-based swap dealer requirements.

To the extent that non-U.S. counterparties prefer to trade with dealers that are subject to the full set of Title VII security-based swap dealer requirements and the associated safeguards, in the absence of the notification condition, non-U.S. persons that rely on the exception could bear lower regulatory costs than registered security-based swap dealers but may nevertheless be regarded by non-U.S. counterparties as subject to similar Title VII safeguards as registered security-based swap dealers. As a result, these non-U.S. persons potentially could capture the business of non-U.S. counterparties from registered security-based swap dealers that they otherwise might not have captured if the notification condition had been part of the exception. In light of this concern, the Commission believes that requiring such notification to non-U.S. counterparties is preferable to this alternative.

(g) “No Management of Relationship” Condition

When identifying the conditions of the exception, the Commission considered making the exception unavailable where U.S. personnel manage the relationship with the non-U.S. counterparty to the security-based swap. Such a condition might help address concerns that U.S.-based dealers could use the exception to rebook transactions, which are managed by U.S. personnel, to a non-U.S. affiliate to avoid triggering security-based swap dealer registration. However, the

Commission recognizes that there may be challenges in articulating objective criteria to identify when the exception would or would not be available under this type of approach. Even if objective criteria could be articulated, non-U.S. persons seeking to use the exception may have to incur costs to satisfy these criteria on an ongoing basis. In light of these concerns, the Commission believes that the adopted approach is preferable to this alternative.

C. Amendment to Commission Rule of Practice 194

Several key economic effects and tradeoffs inform the Commission’s analysis of adopting new paragraph (c)(2) of Rule of Practice 194.<sup>575</sup>

First, as the Commission discussed in the Rule of Practice 194 Adopting Release,<sup>576</sup> increasing the ability of statutorily disqualified persons to effect or be involved in effecting security-based swap transactions on behalf of SBS Entities may give rise to higher compliance and counterparty risks, increase costs of adverse selection, decrease market participation, and reduce competition among higher quality associated persons and SBS Entities.

Second, at the same time, the scope of conduct that gives rise to disqualification is broad and includes conduct that may not pose ongoing risks to counterparties.<sup>577</sup> In addition, as discussed in the Rule of Practice 194 Adopting Release and in greater detail below, strong disqualification standards can also reduce competition and the volume of service provision.

Third, public information about misconduct can give rise to capital market participants voting with their feet (reputational costs), and labor markets frequently penalize misconduct through firing or other career outcomes in other settings, as discussed in the Rule of Practice 194 Adopting Release. If counterparties perceive the risks related to disqualified associated persons to be high, counterparties may choose to perform more in-depth due diligence related to their SBS Entity counterparties or to transact with SBS Entities without disqualified associated persons.

<sup>575</sup> See Rule of Practice 194 Adopting Release, 84 FR at 4922–43.

<sup>576</sup> See *id.*

<sup>577</sup> As discussed in Part V.A. of the Rule of Practice 194 Adopting Release, the definition of disqualified persons, as applied in the statutory prohibition in Exchange Act Section 15F(b)(6), is broad. That definition disqualifies associated persons due to violations of the securities laws, but also for felonies and misdemeanors not related to the securities laws and/or financial markets, and certain foreign sanctions. See *id.* at 4922, 4929.

Fourth, an overwhelming majority of dealers and most counterparties transact across both swap and security-based swap markets, including in financial products that are similar or identical in their payoff profiles and risks. As discussed in the Rule of Practice 194 Adopting Release, differential regulatory treatment of disqualification in swap and security-based swap markets may disrupt existing counterparty relationships and may increase costs of intermediating transactions for some SBS Entities, which may be passed along to certain counterparties in the form of higher transaction costs.

Fifth, as also discussed in the Rule of Practice 194 Adopting Release, market participants may value bilateral relationships with SBS Entities, including with SBS Entities dually-registered as Swap Entities, and searching for and initiating bilateral relationships with new SBS Entities may involve costs for counterparties. For example, security-based swaps are long-term contracts that are often renegotiated, and disruptions to existing counterparty relationships can reduce the potential future ability to modify a contract, which may be priced in widening spreads.<sup>578</sup>

1. Costs and Benefits of the Amendment

Once compliance with SBS Entity registration rules is required, registered SBS Entities will be unable to utilize any statutorily disqualified associated natural person, including natural persons with potentially valuable capabilities, skills, or expertise, to effect or be involved in effecting security-based swap transactions, absent relief, including an order under Rule of Practice 194. Absent the exclusion in Rule of Practice 194(c)(2), the statutory disqualification prohibition set forth in Section 15F(b)(6) of the Exchange Act would apply to all associated natural persons effecting or involved in effecting security-based swap transactions on behalf of all registered SBS Entities regardless of the nature of the conduct giving rise to the disqualification.<sup>579</sup> SBS Entities are, under the baseline regulatory regime, unable to rely on statutorily disqualified associated persons even if such persons are non-U.S. persons transacting exclusively with non-U.S. counterparties. However, absent the exclusion provided in Rule of Practice

<sup>578</sup> See *id.* at 4922.

<sup>579</sup> As noted above, Section 3(a)(39) of the Exchange Act generally defines the circumstances that would subject a person to a statutory disqualification with respect to membership or participation in, or association with a member of, an SRO. See 15 U.S.C. 78c(a)(39).

<sup>573</sup> See Part II.C.4, *supra*.

<sup>574</sup> See Part VI.B.2, *supra*.

194(c)(2), SBS Entities would still be able to apply to the Commission for relief, and the Commission would still be able to grant relief, including under Rule of Practice 194.

Under the exclusion provided in Rule of Practice 194(c)(2), unless a limitation applies,<sup>580</sup> SBS Entities will be able to allow statutorily disqualified associated natural persons that are not U.S. persons to effect or be involved in effecting security-based swap transactions with non-U.S. counterparties and foreign branches of U.S. counterparties. The Commission received comment generally in support of the proposed amendment<sup>581</sup> and continues to believe that amendment to Rule of Practice 194, to include subparagraph (c)(2), involves three possible benefits.

First, SBS Entities may benefit from greater flexibility in hiring and managing non-U.S. employees transacting with foreign counterparties and foreign branches of U.S. counterparties. To the degree that such employees may have valuable skills, expertise, or counterparty relationships that are difficult to replace and outweigh the reputational and compliance costs of continued association, SBS Entities would be able to continue employing them without being required to apply for relief with the Commission. In addition, cross-registered SBS Entities would experience economies of scope in employing non-U.S. natural persons in their swap and security-based swap businesses. Specifically, SBS Entities will be able to rely on the same non-U.S. natural persons in transactions with the same counterparties across integrated swap and security-based swap markets. In addition, SBS Entities will no longer be required to apply for relief under Rule of Practice 194 with respect to non-U.S. persons transacting with foreign counterparties and foreign branches of U.S. counterparties.<sup>582</sup>

Second, to the degree that SBS Entities currently pass along costs to counterparties in the form of, for example, higher transaction costs, the amendment may benefit non-U.S. counterparties and foreign branches of U.S. counterparties through lower prices of available security-based swaps. In

addition, such counterparties of SBS Entities would be able to continue transacting with the same non-U.S. associated persons of the same SBS Entities across interconnected markets without delays related to Commission review under Rule of Practice 194. Both the returns and the risks from security-based swap transactions by foreign branches of U.S. persons may flow to the U.S. business of U.S. persons, contributing to profits and losses of U.S. persons.

Third, the amendment may benefit disqualified non-U.S. natural persons seeking to engage in security-based swap activity. Under the amendment, an SBS Entity would no longer be required to incur costs related to applying for relief under Rule of Practice 194 in order to allow a disqualified non-U.S. natural person to transact with foreign counterparties and foreign branches of U.S. counterparties. The amendment to Rule of Practice 194, to include subparagraph (c)(2), may reduce direct costs to SBS Entities of hiring and retaining disqualified non-U.S. employees. This may improve employment opportunities for disqualified non-U.S. natural persons in the security-based swap industry. However, research in other contexts points to large reputational costs from misconduct, and some papers show that employers may often fire and replace employees engaging in misconduct to manage these reputational costs, as discussed in the Rule of Practice 194 Adopting Release.<sup>583</sup>

Rule of Practice 194(c)(2) would result in SBS Entities being less constrained by the general statutory prohibition in their security-based swap activity with foreign counterparties and foreign branches of U.S. counterparties. The Commission continues to recognize that associating with statutorily disqualified natural persons effecting or involved in effecting security-based swaps on behalf of SBS Entities may give rise to counterparty and compliance risks. For example, as the Commission discussed elsewhere, in other settings, individuals engaged in misconduct are significantly more likely to engage in repeated misconduct.<sup>584</sup> Data in the Rule of Practice 194 Adopting Release suggests that, in analogous disqualification review processes in swap and broker-dealer settings, the application rate is low, but there are incidences of repeated misconduct.<sup>585</sup> The Commission also continues to recognize that statutory

disqualification and an inability to continue associating with SBS Entities creates disincentives against underlying misconduct for associated persons and that there may be spillover effects on other associated persons within the same SBS Entity.<sup>586</sup> Further, the Commission recognizes that, under the amendment, the Commission would be unable to make an individualized determination about whether permitting a given non-U.S. associated natural person to effect or be involved in effecting security-based swaps on behalf of an SBS Entity is consistent with the public interest.

The Commission also notes that the amendment would allow SBS Entities to rely on disqualified non-U.S. personnel in their transactions with both foreign counterparties and foreign branches of U.S. counterparties. To the degree that statutory disqualification may increase risks to counterparties, to the degree that SBS Entities may choose to rely on disqualified foreign personnel despite reputational and compliance costs of association, and to the extent that such counterparties do not move their business to other personnel or SBS Entity, this may increase risks to foreign branches of U.S. counterparties. Depending on the consolidation and ownership structure of counterparties, some of the returns as well as losses in foreign branches may flow through to some U.S. parent firms. However, the adopted approach provides for identical treatment of foreign counterparties and foreign branches of U.S. counterparties, reducing potential competitive disparities between them in security-based swap markets.

Importantly, the exclusion would more closely harmonize the Commission's approach with the approach already being followed with respect to foreign personnel of Swap

<sup>580</sup> An SBS Entity would not be able to avail itself of the exclusion in paragraph (c)(2) if an associated person is currently subject to certain orders.

<sup>581</sup> See, e.g., EBF letter at 6; IIB/SIFMA letter at 5, 29–30; ISDA letter at 3, 16; see also European Commission email.

<sup>582</sup> As discussed in the economic baseline, the exclusion may reduce the number of applications by between one and four applications, resulting in potential cost savings of between \$12,690 (=1 × 30 hours × Attorney at \$423 per hour) and \$50,760 (=4 × 30 hours × Attorney at \$423 per hour).

<sup>583</sup> See Rule of Practice 194 Adopting Release, 84 FR at 4932.

<sup>584</sup> For a more detailed discussion, see *id.*

<sup>585</sup> See *id.* at 4928.

<sup>586</sup> For example, as discussed in the Rule of Practice Adopting Release, Dimmock, Gerken, and Graham (2018) examine customer complaints against FINRA-registered representatives in 1999 through 2011, and argue that misconduct of individuals influences the misconduct of their coworkers. Using mergers of firms as a quasi-exogenous shock, the paper examines changes in an adviser's misconduct around changes to an employee's coworkers due to a merger. The paper estimates that an employee is 37% more likely to commit misconduct if her new coworkers encountered in the merger have a history of misconduct. The paper contributes to broader evidence on peer effects, connectedness, and commonality of misconduct, and can help explain the distributional properties in the prevalence of misconduct across firms documented in Egan, Matvos, and Seru (2017). See Stephen G. Dimmock, William C. Gerken, & Nathaniel P. Graham, *Is Fraud Contagious? Coworker Influence on Misconduct by Financial Advisors*, 73 J. Fin. 1417 (2018); see also Mark Egan, Gregor Matvos, & Amit Seru, *The Market for Financial Adviser Misconduct*, 127 J. POL. ECON. 233 (2019).

Entities. As such, the Commission's assessment of the benefits and potential counterparty risks of the relief discussed above is informed by experience and data with respect to CFTC/National Futures Association statutory disqualification review in swap markets, including, among others: (i) The low incidence of statutory disqualification of associated persons; (ii) the majority of applications arising out of non-investment related conduct by associated persons; and (iii) the absence of additional statutory disqualification forms filed by swap dealers to request NFA determination with respect to a new statutory disqualification for any of the individuals.<sup>587</sup> The Commission also notes that parallel swap markets remain large, with multi-name credit default swaps representing an increasing share of credit-default swap notional outstanding, and highly liquid.<sup>588</sup>

Three factors may reduce the magnitude of the above economic costs and benefits. First, the Commission will continue to be able, in appropriate cases, to institute proceedings under Exchange Act Section 15F(l)(3) to determine whether the Commission should censure, place limitations on the activities or functions of such person, suspend for a period not exceeding 12 months, or bar such person from being associated with an SBS Entity.<sup>589</sup>

Second, the security-based swap market is an institutional one, with investment advisers, banks, pension funds, insurance companies, and ISDA-recognized dealers accounting for 99.8% of transaction activity.<sup>590</sup> While security-based swaps may be more opaque than equities and bonds and may give rise to greater information asymmetries between dealers and non-dealer counterparties, institutional counterparties may be more informed and sophisticated compared to retail clients. However, given limited data availability on the domiciles of non-dealer counterparties, the Commission is unable to quantify how many non-institutional foreign counterparties may be affected by the Rule.

Importantly, the concentrated nature of security-based swap market-facing

activity may reduce the ability of counterparties to choose to transact with SBS Entities that do not rely on disqualified personnel. As the Commission estimated elsewhere, the top five dealer accounts intermediated approximately 55% of all SBS Entity transactions by gross notional, and the median counterparty transacted with 2 dealers in 2017.<sup>591</sup> While reputational incentives may flow from a customer's willingness to deal with an SBS Entity, the fact that the customer may not have many dealers to choose from weakens those incentives. However, the Commission also notes that market concentration is itself endogenous to market participants' counterparty selection. That is, counterparties trade off the potentially higher counterparty risk of transacting with SBS Entities that rely on disqualified associated persons against the attractiveness of security-based swaps (price and non-price terms) that they may offer. If a large number of counterparties choose to move their business to SBS Entities that do not rely on disqualified associated persons (including those SBS Entities that may currently have lower market share), market concentration itself can decrease.

Third, as discussed above, the exclusion will not be available with respect to an associated person if that associated person is currently subject to an order described in subparagraphs (A) and (B) of Section 3(a)(39) of the Exchange Act, with the limitation that an order by a foreign financial regulatory authority described in subparagraphs (B)(i) and (B)(iii) of Section 3(a)(39) shall only apply to orders by a foreign financial regulatory authority in the jurisdiction where the associated person is employed or located. In such circumstances, affected SBS Entities will be required to apply for relief under Rule of Practice 194 and will be unable to allow their disqualified associated person entities to effect or be involved in effecting security-based swaps on their behalf, pending review by the Commission.

## 2. Effects on Efficiency, Competition, and Capital Formation

The Commission has assessed the effects of the amendment on efficiency, competition, and capital formation. As noted above, limiting the ability of statutorily disqualified persons to effect or be involved in effecting security-based swaps on behalf of SBS Entities may reduce compliance and counterparty risks and may facilitate competition among higher quality

associated persons and SBS Entities, thereby enhancing integrity of security-based swap markets. At the same time, limits on the participation of disqualified employees in security-based swap markets may result in costs related to replacing or reassigning an employee to SBS Entities or applying to the Commission for relief. This may disrupt existing counterparty relationships across closely linked swap and security-based swap markets and increase transaction costs borne by counterparties, adversely effecting efficiency and capital formation in swap and security-based swap markets.

In addition, if more SBS Entities seek to avail themselves of the exclusion and retain, hire, or increase their reliance on disqualified foreign personnel in their transactions with foreign counterparties, a greater number of disqualified persons may seek employment and business opportunities in security-based swap markets. As discussed in the Rule of Practice 194 Adopting Release,<sup>592</sup> there is a dearth of economic research on these issues in derivatives markets, and the research in other settings cuts both ways. On the one hand, a greater number of disqualified persons active in security-based swaps could increase the "lemons" problem and related costs of adverse selection,<sup>593</sup> since market participants may demand a discount from counterparties if they expect a greater chance that counterparties have employed disqualified persons that are involved in arranging transactions. This effect could lead to a reduction in informational efficiency and capital formation. On the other hand, more flexibility in employing disqualified persons may also increase competition and consumer surplus.<sup>594</sup>

<sup>592</sup> See Rule of Practice 194 Adopting Release, 84 FR at 4923.

<sup>593</sup> See, e.g., George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q. J. Econ. 488 (1970). Informational asymmetry about quality can negatively affect market participation and decrease the amount of trading—a problem commonly known as adverse selection. When information about counterparty quality is scarce, market participants may be less willing to enter into transactions, and the overall level of trading may fall.

<sup>594</sup> See Jonathan Berk & Jules H. van Binsbergen, *Regulation of Charlatans in High-Skill Professions* (Stanford University Graduate School of Business, Research Paper No. 17–43, 2017), available at <https://ssrn.com/abstract=2979134>. The paper models the costs and benefits of both disclosure and standards regulation of "charlatans" (professionals who sell a service they do not deliver) in high skill professions. When there is a mismatch between high demand for a skill and short supply of the skill, the presence of charlatans in a profession is an equilibrium outcome. Importantly, reducing the number of charlatans by regulation decreases consumer surplus in their model. Both standards and disclosure regulations drive charlatans out of

<sup>587</sup> See Rule of Practice Adopting Release, 84 FR at 4931.

<sup>588</sup> See, e.g., Inaki Aldasoro & Torsten Ehlers, *The Credit Default Swap Market: What a Difference a Decade Makes*, BIS Q. Rev., June 2018, at 3 (Graph 1), available at [https://www.bis.org/publ/qtrpdf/r\\_qt1806b.pdf](https://www.bis.org/publ/qtrpdf/r_qt1806b.pdf), last accessed March 26, 2019; see also Richard Haynes & Lihong McPhail, *The Liquidity of Credit Default Index Swap Networks* (Working Paper, 2017).

<sup>589</sup> See 15 U.S.C. 78o–10(l)(3).

<sup>590</sup> See Rule of Practice 194 Adopting Release, 84 FR at 4925–26, Table 1.

<sup>591</sup> See *id.* at 4925.

The amendment would preserve an equal competitive standing of U.S. and non-U.S. SBS Entities with disqualified foreign personnel as they compete for business with foreign counterparties and foreign branches of U.S. counterparties. Importantly, under the baseline, both U.S. and non-U.S. Swap Entities are able to transact with foreign counterparties relying on their foreign disqualified personnel without applying to the CFTC for relief from the statutory prohibition. As discussed in the economic baseline, the Commission expects extensive cross-registration of dealers across the two markets. As a result of the exclusion being adopted, dually registered U.S. SBS Entities would be more likely to be able to rely on at least some of the same disqualified foreign personnel in transacting with the same counterparties in both swap (e.g., index CDS) and security-based swap (e.g., single-name CDS) markets.

The amendment may create incentives for SBS Entities to relocate their personnel (or the activities performed by U.S. personnel) outside the U.S. to be able to avail themselves of the exclusion and avoid being bound by the statutory prohibition. The cost of relocation will depend on many factors, such as the number of positions being relocated, the location of new operations, the costs of operating at the new location, and other factors. These factors will, in turn, depend on the relative volumes of market-facing activity that a firm carries out on different underliers and with counterparties in different jurisdictions. As a result of these dependencies, the Commission cannot reliably quantify the costs of these alternative approaches to compliance. However, the Commission believes that firms would seek to relocate their personnel (or the activities performed by U.S. personnel) only if they expect the relocations to be profitable.

Further, the amendment may improve the employment and career outcomes of disqualified foreign personnel relative to disqualified U.S. personnel. As a result, disqualified personnel may seek to relocate outside the U.S. and seek employment by SBS Entities in their foreign business. To the degree that such relocation occurs, it may reduce the effective scope of application of the statutory prohibition. This may also lead to a separating equilibrium: It may decrease counterparty risks and adverse selection costs of security-based swaps

in SBS Entities and in transactions with U.S. counterparties and increase counterparty risks and adverse selection costs in transactions with foreign counterparties and foreign branches of U.S. counterparties.

### 3. Alternatives Considered

The Commission has considered several alternatives to the amendment to Rule of Practice 194(c)(2).

#### (a) Relief for All SBS Entities With Respect to Non-U.S. Personnel Transacting With Non-U.S. Counterparties But Not With Foreign Branches of U.S. Counterparties

The Commission could have adopted an exclusion for all SBS Entities with respect to foreign personnel transacting with foreign counterparties, without making the exclusion available to foreign personnel transacting with foreign branches of U.S. counterparties. As discussed above, a history of statutorily disqualifying conduct may signal higher ongoing risks to counterparties. SBS Entities may choose to replace disqualified foreign personnel due to reputational and compliance costs. In addition, the security-based swap market is institutional in nature, and better informed institutional counterparties may choose to move their business to another employee or another SBS Entity without disqualified personnel. To the degree that SBS Entities do not replace disqualified personnel and counterparties do not move their business, the alternative may decrease risks to foreign branches of U.S. counterparties relative to the adopted approach. Since both potential returns and potential risks of foreign branches may flow through to some U.S. parents (depending on the counterparty's ownership and organizational structure), the alternative could reduce the returns and risks of such U.S. counterparties' parents.

At the same time, the alternative approach would involve unequal effects on foreign counterparties and foreign branches of U.S. counterparties. Specifically, under the alternative, foreign counterparties would be able to choose between transacting with those SBS Entities that employ statutorily disqualified personnel and those that do not, whereas foreign branches of U.S. counterparties would only be able to transact with SBS Entities that do not employ statutorily disqualified personnel. If SBS Entities with disqualified personnel compensate for potentially higher counterparty risks with, for example, more attractive terms of security-based swaps, the alternative may introduce disparities in access and

cost of security-based swaps available to foreign counterparties as compared to those available to foreign branches of U.S. counterparties.

#### (b) Relief for Non-U.S.-Person SBS Entities With Respect to Non-U.S. Personnel Transacting With Non-U.S. Counterparties and Foreign Branches of U.S. Counterparties

The Commission has considered a narrower alternative exclusion limited to non-U.S.-person SBS Entities relying on non-U.S. personnel in their transactions with foreign counterparties and foreign branches of U.S. counterparties. The alternative exclusion would be subject to the same limitation as the amendment, discussed above: An SBS Entity would not be able to rely on the exclusion with respect to an associated person currently subject to an order that prohibits such person from participating in the U.S. financial markets, including the securities or swap market, or foreign financial markets.

Relative to the amendment, this alternative would broaden the effective scope of application of the statutory prohibition and might reduce ongoing compliance and counterparty risks for foreign counterparties and foreign branches of U.S. counterparties. Under the alternative, disqualified foreign personnel of U.S. SBS Entities would be unable to transact without the costs and delays related to applications for relief. This might decrease the number of disqualified foreign personnel transacting in security-based swap markets and seeking to associate with U.S. SBS Entities. Lower market participation of disqualified personnel on behalf of U.S. SBS Entities in their foreign transactions may reduce the costs of adverse selection and increase foreign counterparty willingness to transact with U.S. SBS Entities in security-based swaps.

At the same time, it would result in a disparate competitive standing between U.S. SBS Entities and non-U.S.-person SBS Entities as they are competing for business with foreign counterparties and foreign branches of U.S. counterparties. This alternative would allow nonresident SBS Entities to enjoy flexibility in hiring, retaining, and replacing non-U.S. personnel and in staffing foreign offices with personnel engaged in transactions with foreign counterparties. However, U.S. SBS Entities would be unable to rely on the exclusion and would have to either replace an employee or apply under Rule of Practice 194, incurring related costs and delays. To the degree that SBS Entities pass along costs to their

the market, but the resulting reduction in competition amongst producers actually reduces consumer surplus. In turn, producers strictly benefit from such regulation.



counterparties, relative to the exclusion, this narrower alternative may result in somewhat lower availability or worse terms of security-based swaps and may somewhat reduce the choice of dealers for foreign counterparties and foreign branches of U.S. counterparties.

Further, under the alternative, foreign personnel of U.S. SBS Entities would not have the same competitive standing as foreign personnel of non-U.S. SBS Entities when engaging in business with the same foreign counterparties. The Commission also notes that the definition of a U.S. person is based on a natural person's residency in the United States. As discussed above, excluding foreign personnel of foreign SBS Entities creates incentives for all disqualified U.S. personnel employed by foreign SBS Entities to be transferred to a foreign office in order to legally become non-U.S. personnel eligible for the alternative exclusion. Of course, the choice made by a non-U.S. SBS Entity to transfer disqualified U.S. personnel abroad will reflect the value of an employee's skills and expertise, costs to reputation with counterparties, the number of positions being moved, and internal organizational structures of a non-U.S. SBS Entity. However, SBS Entities are commonly part of large financial groups with many domestic and foreign regional offices. Therefore, many non-U.S. SBS Entities may be able to relocate statutorily disqualified U.S. personnel to foreign offices and rely on the exclusion.

Under this alternative, however, disqualified personnel of U.S. SBS Entities would be unable to relocate to a foreign office and rely on the exclusion, adding to the competitive disparities between disqualified personnel of U.S. and foreign SBS Entities transacting with the same foreign counterparties. As a result, under the alternative, statutorily disqualified personnel of U.S. SBS Entities may seek employment with foreign SBS Entities and continue to transact with the same foreign counterparties on behalf of non-U.S. SBS Entities.

The Commission continues to recognize that, due to adverse selection costs and compliance risks related to hiring and retaining disqualified persons, many SBS Entities may choose not to hire or may fire and replace statutorily disqualified employees. However, this incentive may be weaker with respect to personnel whose conduct giving rise to disqualification occurred in jurisdictions where statutory disqualification is not public information.

#### (c) Relief for Non-U.S. SBS Entities With Respect to Both U.S. and Non-U.S. Personnel Transacting With Foreign Counterparties and Foreign Branches of U.S. Counterparties

The Commission has considered excluding from the statutory prohibition both U.S. and foreign disqualified personnel, but limiting the relief to non-U.S.-person SBS Entities transacting exclusively with foreign counterparties or foreign branches of U.S. counterparties. The alternative exclusion would be subject to the same limitation as the amendment, discussed above: An SBS Entity would not be able to rely on the exclusion with respect to an associated person currently subject to an order that prohibits such person from participating in the U.S. financial markets, including the securities or swap market, or foreign financial markets.

Under the alternative, non-U.S. SBS Entities would enjoy full flexibility in hiring, retaining, and replacing personnel and in staffing both U.S. and non-U.S. offices with personnel engaged in transactions with foreign counterparties. To the degree that non-U.S. SBS Entities pass along costs to their counterparties, this may result in somewhat higher availability or improved terms of security-based swaps for foreign counterparties. Further, under the alternative, disqualified U.S. personnel would have the same competitive standing as disqualified foreign personnel with similar skills and expertise transacting on behalf of non-U.S. SBS Entities with the same foreign counterparties. For example, disqualified U.S. personnel transacting with foreign counterparties and foreign branches of U.S. counterparties would not need to relocate to a foreign office of a foreign SBS Entity to avail themselves of the exclusion.

Relative to the Rule, this alternative would increase the competitive gap between U.S. and non-U.S. SBS Entities in their ability to hire, retain, and locate disqualified personnel as they compete for business with foreign counterparties. To the degree that U.S. SBS Entities may wish to begin or continue to associate with disqualified personnel despite potential reputation costs, U.S. SBS Entities would be required to apply with the Commission and disallow disqualified personnel from effecting security-based swaps pending Commission action. At the same time, foreign SBS Entities would be able to freely hire and retain disqualified personnel in the U.S. and allow them to engage in security-based swap transactions with foreign counterparties

and foreign branches of U.S. counterparties.

As noted in the economic baseline, this alternative approach is inconsistent with the relief from the CFTC's requirements that is available to both U.S. and non-U.S. SBS Entities with respect to only foreign personnel. Given expected extensive cross-registration and active cross-market participation by counterparties, differential treatment of disqualification may disrupt counterparty relationships between the same dually registered SBS Entities transacting with the same foreign counterparties in related markets.

Under the alternative and relative to the amendment, disqualified U.S. personnel of non-U.S. SBS Entities may enjoy better employment and career outcomes, which may increase the number of disqualified personnel transacting in security-based swap markets and seeking to associate with SBS Entities. Greater market participation of disqualified personnel on behalf of non-U.S. SBS Entities, particularly in jurisdictions where conduct giving rise to disqualification is not public or easily accessible information, may increase the costs of adverse selection and decrease counterparty willingness to transact with non-U.S. SBS Entities in security-based swaps. As a result, some foreign counterparties may choose to move their transaction activity from non-U.S. to U.S. SBS Entities.

The magnitude of the above economic effects of the alternative approach may be limited by three factors. First, many non-U.S. SBS Entities may choose to locate personnel transacting with foreign counterparties in foreign offices if most of their business is in foreign underliers trading in foreign jurisdictions.<sup>595</sup> As a result, some non-U.S. SBS Entities may already locate personnel, including statutorily disqualified personnel, dedicated to transacting with foreign counterparties outside the United States.

Second, due to reputational and adverse selection costs and compliance risks related to hiring and retaining disqualified persons, many SBS Entities may choose not to hire, or may fire and replace disqualified employees. The incentive to disassociate is strongest in jurisdictions in which conduct giving rise to statutory disqualification is public information (as in the U.S.). As a result, it is not clear how often non-U.S. SBS Entities would choose to hire or

<sup>595</sup> As discussed in Part VII.A.2.c, *infra*, we understand that many market participants engaged in market-facing activity prefer to use traders and manage risk for security-based swaps in the jurisdiction where the underlying security is traded.

continue to employ disqualified U.S. personnel even if they were able to rely on an exclusion and avoid applying for relief under Rule of Practice 194.

Third, the primary difference between the adopted approach and the alternative is in the treatment of U.S. SBS Entity personnel. Specifically, under the amendment, U.S. SBS Entities may permit non-U.S. personnel to transact with foreign counterparties and foreign branches of U.S. counterparties, whereas under the alternative they may not. With respect to non-U.S. SBS Entities, the amendment provides relief for foreign personnel only; the alternative provides relief with respect to both U.S. and foreign personnel. As discussed above, the definition of a U.S. person in Rule 3a71-3(a)(4)(i)(A) under the Exchange Act with respect to a natural person is based on residency in the United States. Under the amendment, non-U.S. SBS Entities may be able to simply transfer statutorily disqualified U.S. personnel transacting with foreign counterparties to a foreign office in order to become eligible for the exclusion. Of course, each non-U.S. SBS Entity's choice to continue to employ disqualified U.S. personnel and relocate them abroad would likely reflect the value of an employee's skills and expertise, reputational costs of continued association, the number of positions being moved, and internal organizational structures of each entity, among others. However, non-U.S. SBS Entities are commonly members of large financial groups with many domestic and foreign regional offices, and such relocation is likely to be feasible for some non-U.S. SBS Entities. As a result, depending on the ease and costs of such relocation and the value of disqualified personnel to the non-U.S. SBS Entity, the scope of this alternative with respect to non-U.S. SBS Entities may be similar to the effective scope of the exclusion with respect to non-U.S. SBS Entities.

**(d) Relief for All SBS Entities With Respect to All Personnel Transacting With Non-U.S. Counterparties and Foreign Branches of U.S. Counterparties**

The Commission has considered an exclusion for both U.S. and foreign SBS Entities with respect to all personnel transacting with foreign counterparties and foreign branches of U.S. counterparties. The alternative exclusion would be subject to the same limitation as the amendment, discussed above: An SBS Entity would not be able to rely on the exclusion with respect to an associated person currently subject to an order that prohibits such person from participating in the U.S. financial markets, including the securities or

swap market, or foreign financial markets.

This alternative would allow both non-U.S. and U.S. SBS Entities to enjoy full flexibility in hiring, retaining, and replacing personnel, and in staffing both U.S. and non-U.S. offices with personnel engaged in transacting with foreign counterparties and foreign branches of U.S. counterparties. To the degree that SBS Entities currently pass along costs to their counterparties or to the degree disqualified personnel may have superior skills or expertise, this may benefit the terms of security-based swaps and choice of dealers available to foreign counterparties. Further, disqualified U.S. personnel would have the same competitive standing as disqualified foreign personnel with similar skills and expertise transacting on behalf of SBS Entities with the same foreign counterparties.

Relative to the exclusion, this alternative provides more relief from the statutory prohibition and may, thus, increase ongoing compliance and counterparty risks for foreign counterparties and foreign branches of U.S. counterparties. Since all disqualified personnel of all SBS Entities transacting with foreign counterparties and foreign branches of U.S. counterparties would be excluded from the statutory prohibition, more disqualified personnel may seek to associate with both U.S. and foreign SBS Entities and to transact with foreign counterparties and foreign branches of U.S. counterparties. However, as discussed elsewhere in this release and in the Rule of Practice 194 Adopting Release, one of the key disincentives against continued association with disqualified personnel may be reputational. To the degree that information about the disqualifying conduct by U.S. personnel may be public and institutional customers perceive disqualification as increasing counterparty risk, counterparties may move their business, and SBS Entities may simply replace disqualified U.S. personnel. As a result, it is not clear that SBS Entities would significantly increase their reliance on disqualified personnel in transactions with foreign counterparties and foreign branches of U.S. counterparties relative to the baseline or the adopted approach. Nevertheless, to the degree that they may do so, greater market participation of disqualified personnel may increase adverse selection costs and decrease such counterparties' willingness to participate in security-based swap markets.

As noted above, a natural person's residency in the United States is

endogenous. As a result, any exclusion for foreign personnel, but not U.S. personnel, transacting with foreign counterparties may result in SBS Entities simply transferring disqualified U.S. personnel to a foreign office. As the Commission recognized above, this decision by an SBS Entity will reflect the uniqueness and value of an employee's skills, expertise, and client relationships relative to the reputational costs and compliance risks of continuing to employ disqualified personnel and directs costs of personnel transfers. However, SBS Entities that belong to large global financial groups are less likely to be constrained by the location of disqualified personnel whom they prefer to retain. As a result, the economic effects of this alternative may be similar to those of the adopted approach.

**(e) Relief for All SBS Entities With Respect to Non-U.S. Personnel Effecting and Involved in Effecting Security-Based Swaps With U.S. and Non-U.S. Counterparties**

The Commission has also considered alternatives excluding from the statutory prohibition non-U.S. associated persons involved in effecting security-based swaps with both U.S. and non-U.S. counterparties in general, or under certain circumstances. For example, the Commission has considered excluding from the statutory prohibition non-U.S. associated persons involved in effecting security-based swaps with U.S. counterparties, if such activity is limited in level or scope (e.g., collateral management).

As discussed in the economic baseline above, security-based swap markets are global and many SBS Entities actively participate across U.S. and non-U.S. markets. Due to economies of scale and scope, some SBS Entities may choose not to separate customer facing and/or operational activities, such as collateral management and clearing, related to security-based swaps with U.S. and non-U.S. counterparties. To the degree that some SBS Entities rely on the same personnel across their U.S. and non-U.S. business, they are currently unable to hire and retain statutorily disqualified personnel absent relief by the Commission. As discussed above, SBS Entities may face reputational costs from retaining disqualified employees. To the degree that SBS Entities would prefer to hire and retain certain disqualified employees due to their superior expertise, skills, and abilities, and despite such reputational costs, the alternative would provide beneficial flexibility in personnel decisions

without necessitating an SBS Entity to completely separate the operational side of their U.S. and non-U.S. businesses (and more flexibility relative to the amendment). Some of these benefits may flow through to counterparties in the form of more efficient execution of security-based swaps and related services, or better price and non-price terms.

To the degree that statutory disqualification of associated persons may increase compliance and counterparty risks, the alternative may involve greater risks to U.S. counterparties of SBS Entities relative to the amendment. The Commission continues to note that the scope of conduct that gives rise to statutory disqualification is broad and includes conduct that is not related to investments or financial markets. Moreover, the security-based swap market is an institutional one, and conduct that gives rise to statutory disqualification in the U.S. is generally

public. U.S. counterparties that believe statutory disqualification is a meaningful signal of quality may vote with their feet and choose to transact with non-disqualified personnel or SBS Entities that do not rely on disqualified personnel.

The alternative would provide broader relief compared to CFTC's requirements in swap markets and would not result in a harmonized regulatory regime with respect to statutory disqualification. Importantly, the full costs and benefits of an alternative that provides broader relief from the statutory prohibition in security-based swaps compared to the relief available in swap markets may not be realized. Specifically, to the degree that market participants transact across swap and security-based swap markets with the same SBS Entity counterparties, SBS Entities may continue to rely on the same personnel who are allowed to effect or be involved

in both swaps and security-based swap transactions.

(f) Relief With Respect to Certain Non-U.S. Middle- and Back-Office Associated Persons

As discussed above, the Commission has considered two alternatives that would exclude certain non-U.S. middle- or back-office associated persons from the scope of the statutory disqualification prohibition in Section 15F(b)(6).<sup>596</sup> The first alternative would exclude non-U.S. associated persons involved in drafting and negotiating master agreements and confirmations and managing collateral for the SBS Entity from the statutory prohibition. The second alternative would be broader and also exclude from the statutory prohibition associated persons involved in structuring or supervisory functions, leaving only sales and trading persons considered "involved in effecting" security-based swaps and subject to the statutory prohibition.

TABLE 4—ESTIMATES OF ASSOCIATED PERSONS AFFECTED BY THE PROPOSAL AND ALTERNATIVES<sup>597</sup>

Estimate	Bank 1	Bank 2	Bank 3	Bank 4	Bank 5	Bank 6
Baseline <sup>598</sup>	3,750	2,150–2,250	2,100	2,100	1,340	>6,800
Proposal <sup>599</sup>	1,125	1,350–1,400	700–800	<sup>600</sup> 1,680	650–750	>1,000
Alternative 1 <sup>601</sup>	875	850	100–200	n.a	560	700
Alternative 2 <sup>602</sup>	288	750	<sup>603</sup> 100	<sup>604</sup> 700	n.a	n.a

TABLE 5—PERCENTAGE REDUCTION IN ASSOCIATED PERSONS BASED ON DATA PROVIDED BY 6 MARKET PARTICIPANTS<sup>605</sup>

Panel A. Reduction Relative to the Market Participant Estimates of the Baseline			
Estimate	Average (%)	Minimum (%)	Maximum (%)
Proposal	54	20	85
Alternative 1	76	58	93
Alternative 2	80	66	95
Panel B. Reduction Relative to the Market Participant Estimates of the Proposal			
Alternative 1	38	20	80
Alternative 2	66	45	87

Based on estimates summarized in Tables 4 and 5 above, the first alternative may reduce the scope of application of the statutory prohibition

with respect to associated persons by an average of 76% relative to baseline estimates in the survey, with a range of estimates between 58% and 93%. The

second alternative may reduce the scope of application of the statutory prohibition with respect to associated persons by an average of 80% relative to

<sup>596</sup> See EBF letter at 6; IIB/SIFMA letter at 5, 30; ISDA letter at 3, 16.

<sup>597</sup> See European Commission email.

<sup>598</sup> Range of associated persons if global SBS associated persons are taken into account, with broad definition and accounting for back office.

<sup>599</sup> Remaining range of associated persons after accounting for potential reduction of this number when removing personnel with no U.S. person contacts.

<sup>600</sup> This figure represents an estimate of "only those associated persons authorized to communicate directly with U.S. persons."

<sup>601</sup> Remaining range of associated persons after accounting for potential further reduction of the number by excluding back office functions.

<sup>602</sup> Remaining range of associated persons after accounting for potential further reduction by focusing exclusively on personnel with sales or trader mandates for derivatives.

<sup>603</sup> This figure represents the response "approx. 100 if limited to US-focused associated persons."

<sup>604</sup> This figure represents the response "estimated 700 SBS associated persons for front-office personnel only, and when removing all back-office

functions (comparable to the CFTC associated person approach)."

<sup>605</sup> See European Commission email. Where a market participant provided a range, the percentage reduction was calculated using a midpoint of that range. When a market participant provided an estimate using "over," the percentage reduction assumed the figure was exactly as reported, which may under-estimate the magnitude of the reduction relative to baseline.

baseline estimates in the survey, with a range of estimates between 66% and 95%. In contrast, by adopting the proposed approach, as discussed above, the Commission estimates that the final amendments may reduce the scope of application of the statutory prohibition by approximately 54%, with a range of estimates between 20% and 85%.

Relative to the final approach, both alternatives excluding certain non-U.S. middle- and back-office employees may provide SBS Entities with further flexibility with respect to hiring and retaining disqualified personnel who may have valuable expertise and skills in their security-based swap business with U.S. and non-U.S. counterparties. These alternatives may also involve greater benefits for disqualified persons who may enjoy improved labor market outcomes and a greater likelihood of being hired and retained by SBS Entities in their middle and back-office functions. Such an alternative may also more closely harmonize the treatment of statutory disqualification across tightly linked swap and security-based swap markets.<sup>606</sup>

However, the Commission continues to recognize that, relative to the final approach, and to the degree that statutory disqualification may act as a signal of quality of an associated person, these alternatives may further increase compliance and counterparty risks, including to U.S. counterparties. As discussed in Part IV.B above, the conduct of a variety of middle- and back-office activities beyond solicitations or sales of security-based swaps—activities such as collateral management in connection with security-based swaps—may directly impact the risks and returns of counterparties on security-based swaps. These alternatives may also increase the incentives of U.S. and non-U.S. SBS Entities to move their non-U.S. disqualified personnel into middle- and back-office functions and may result in competitive disadvantages between U.S. and non-U.S. disqualified persons in front- and middle- and back-office functions.

The costs and benefits of these alternatives relative to the final approach are likely to be attenuated by two important considerations. First, as discussed above, the security-based swap market is an institutional one. To the degree that institutional counterparties may view statutory disqualification as a meaningful signal of quality, SBS Entities may still choose to disassociate from disqualified

personnel in middle- and back-office functions to reduce reputational costs. While dealer concentration may reduce the effectiveness of this market discipline, market concentration is itself endogenous. As a result, the benefits of this alternative to SBS Entities and disqualified personnel as well as the potential risks to counterparties may be dampened. Second, under the alternatives, as under the final approach, the Commission would continue to be able, in appropriate cases, to institute proceedings under Exchange Act Section 15F(l)(3) to determine whether the Commission should censure, place limitations on the activities or functions of such person, suspend for a period not exceeding 12 months, or bar such person from being associated with an SBS Entity.<sup>607</sup> However, the Commission reiterates that the conduct of middle- and back-office activities may impact the risks and returns of counterparties and that, as estimated in Table 4, these alternatives may result in a further narrowing of the scope of the statutory prohibition relative to the final approach.

#### *D. Certification, Opinion of Counsel, and Employee Questionnaires*

In addition, the Commission is adopting certain amendments to registration Rule 15Fb2-1, and modifications to the requirement to obtain employee questionnaires under Rules 18a-5(a)(10) and (b)(8).

##### **1. Amendments to Rule 15Fb2-1**

As the Commission stated in the Registration Adopting Release, the Commission's access to books and records and the ability to inspect and examine registered SBS Entities facilitates Commission oversight of security-based swap markets.<sup>608</sup> To the degree that the certification and opinion of counsel requirements of Rule 15Fb2-4 provide assurances regarding the Commission's ability to oversee and inspect and examine nonresident SBS Entities, the baseline certification and opinion of counsel requirements may reduce counterparty and compliance risks and adverse selection.

However, certain nonresident entities may lack clarity concerning the scope of the certification and opinion of counsel requirements and their ability to comply. Specifically, the recent passage of the GDPR, as well as the potential exit of the United Kingdom from the European Union may create significant uncertainty for market participants

currently intermediating large volumes of security-based swaps regarding their ability to comply with the certification and opinion of counsel requirements, as well as the background check recordkeeping requirements discussed below.

The Commission estimates that nonresident SBS Entities currently intermediating approximately 59.8% of all security-based swap notional are subject to foreign privacy and secrecy laws, blocking statutes, and other legal barriers that make it difficult or create uncertainty about their ability to provide certification and opinion of counsel and/or to be subject to inspections and examinations by the Commission.<sup>609</sup> Such nonresident SBS entities may be less likely to apply or may become unable to register as SBS Entities when compliance with SBS Entity registration rules is required.<sup>610</sup> As a result, some nonresident SBS Entities currently intermediating large volumes of security-based swap transactions may cease transaction activity or be forced to relocate certain operations, books, and records. This may result in disruptions to valuable counterparty relationships or increased costs to counterparties (to the degree that nonresident SBS Entities may pass along the costs of such restructuring in

<sup>609</sup> Since we expect a large number of U.S. SBS Entities will have dually registered as Swap Entities, to inform our analysis we considered foreign jurisdictions where CFTC staff previously provided no-action relief for trade repository reporting requirements as they apply to swap dealers (available at <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/15-01.pdf>). This estimate was also informed by a legal analysis of the EU General Data Protection Regulation, foreign blocking statutes, bank secrecy and employment laws, jurisdiction specific privacy laws, and other legal barriers that may inhibit compliance with regulatory requirements. These jurisdictions were matched to the domicile classifications of TIW accounts likely to trigger requirements to register with the Commission as SBS Entities when compliance with registration requirements becomes effective, using 2017 DTCC-TIW data. If foreign jurisdictions amend their data privacy and blocking laws, provide guidance, or enter into international agreements that would facilitate compliance with Commission SBS Entity registration requirements before compliance with SBS Entity registration rules becomes effective, or if SBS Entities choose to restructure their operations and/or relocate their books and records to other jurisdictions (for example, in response to the potential exit of the U.K. from the E.U. or GDPR restrictions), this figure may over- or under-estimate the security-based swap market share impacted by the guidance.

<sup>610</sup> The BIS estimates that as of year-end 2017, the total gross market value outstanding in single-name credit default swaps, in multi-name credit default swap instruments, and in equity forwards and swaps totaled \$501 billion. If the amendment affects even 0.02% of the market, the economic impact of the amendment may exceed \$100 million. See BIS, *Semi-annual OTC derivatives statistics at December 2017*, Table 10.1, available at [https://www.bis.org/statistics/d10\\_1.pdf](https://www.bis.org/statistics/d10_1.pdf) (accessed May 18, 2018).

<sup>606</sup> See EBF letter at 6; IIB/SIFMA letter at 30; ISDA letter at 16; see also Part V, *supra*.

<sup>607</sup> See 15 U.S.C. 78o-10(l)(3).

<sup>608</sup> See Registration Adopting Release, 80 FR at 48972.

the form of higher transaction costs or less attractive security-based swaps). In addition, depending on whether and which SBS Entities step in to intermediate the newly available market share, there may be significant competitive effects.

(a) Costs, Benefits, and Effects on Efficiency, Competition, and Capital Formation

The Commission is cognizant of the fact that SBS Entity Registration rules and other elements of the Title VII regime will apply to an active market. As analyzed in the economic baseline, the Commission recognizes that security-based swap markets involve extensive cross-border activity, and nonresident SBS Entities intermediate a large percentage of security-based swaps. The Commission believes that the nonresident SBS entities that may face uncertainty about their ability to comply with certification and opinion of counsel requirements and are likely to utilize conditional registration are those SBS Entities located in jurisdictions with foreign privacy and secrecy laws, blocking statutes, and other legal barriers described above.

Conditional registration may provide SBS Entities currently active in security-based swap markets with beneficial flexibility and time to relocate some of their operations and/or books and records around the constraints of foreign privacy and secrecy laws, blocking statutes, and other legal barriers, without disrupting ongoing counterparty relationships and market activity. In addition, conditional registration may facilitate smooth functioning of active security-based swap markets as compliance with the Commission's Title VII rules becomes required, may benefit both SBS Entities and counterparties by preserving SBS Entity-counterparty relationships, and may enhance efficiency and capital formation in security-based swaps.

However, conditional registration may reduce the assurances of the certification and opinion of counsel regarding the Commission's ability to inspect and examine some SBS Entities during the 24-month period. In addition, 24 months may not be sufficient for the more complex SBS Entities to relocate and restructure their security-based swap market activity outside the reach of foreign privacy and secrecy laws, blocking statutes, and other legal barriers, particularly as foreign laws, statutes and legal barriers evolve. Thus, under the amendment there may still be a risk of disruptions to counterparty relationships and market activity if conditionally

registered SBS Entities having large market shares, and transacting with hundreds and thousands of counterparties, are unable to meet the certification and opinion of counsel requirements within the 24-month period.

Moreover, counterparties that may rely on the Commission's ability to inspect and examine a registered SBS Entity as a signal of higher quality may reduce their participation in security-based swap markets, which may increase adverse selection. Alternatively, they may vote with their feet and shift business from conditionally registered SBS Entities to non-conditionally registered SBS Entities. This may enhance competition between conditionally registered and non-conditionally registered SBS Entities and may create a market incentive for conditionally registered SBS Entities to provide the certification and opinion of counsel.

(b) Alternatives Considered

The Commission considered alternative approaches. Specifically, the Commission considered adopting some, but not other, aspects of the above relief. For example, the Commission considered shortening the conditional registration period (*e.g.*, to 12 or 18 months). Relative to the final approach, these alternatives would provide less relief and greater uncertainty to nonresident entities that may seek to register with the Commission as an SBS Entity, which may increase the likelihood of disruptions of counterparty relationships and risks of adverse effects on market activity in security-based swaps. At the same time, these alternatives may increase the scope, strength, and/or timeliness of the certification and opinion of counsel requirement, which may give the Commission further assurances regarding its ability to oversee security-based swap activity of nonresident entities applying for registration. Importantly, regardless of the certification and opinion of counsel requirement, all nonresident SBS Entities would continue to have independent ongoing obligations to provide the Commission with access to their books and records and to permit on-site inspections and examinations.

The Commission has considered an alternative under which all conditionally registered SBS Entities would be required to provide disclosures to U.S. counterparties or to all counterparties regarding their conditional registration. Such disclosures may help inform counterparties regarding the conditional

registration status of SBS Entities with which they may wish to transact. To the degree that counterparties may consider conditional registration as a signal of lower quality or may seek to build long-term relationships with non-conditionally registered SBS Entity counterparties, and to the degree such counterparties are otherwise uninformed about SBS Entities' registration status, this alternative may facilitate more efficient counterparty selection. The alternative may also create reputational incentives for conditionally registered SBS Entities to provide the requisite certification and opinion of counsel to the Commission, to the degree that some counterparties may interpret conditional registration as a signal of reduced quality.

However, such disclosure requirements would involve burdens on SBS Entities related to the preparation and production of such disclosures. Related costs may be partly or fully passed along to SBS Entities' counterparties in the form of more expensive security-based swaps. As noted above, the Commission believes that nonresident SBS Entities most likely to utilize conditional registration are those SBS Entities that face uncertainty regarding their ability to comply with certification and opinion of counsel requirements due to privacy and secrecy laws, blocking statutes, and other legal barriers in their foreign jurisdictions. Based on the analysis of 2017 TIW data, the Commission estimates that there are approximately 9,611 unique relationships (pairs of counterparties and accounts likely to trigger SBS Entity registration requirements with registered office locations in jurisdictions with foreign privacy and secrecy laws, blocking statutes, and other legal barriers) or approximately 72.6% of all unique dealer-counterparty pairs active in security-based swap market that may become subject to the disclosure requirement.<sup>611</sup> Limiting such disclosure requirements to relationships between dealer accounts in jurisdictions with foreign privacy and secrecy laws, blocking statutes, and other legal barriers and U.S. non-dealer counterparties may affect 4,322 unique dealer-U.S. counterparty relationships.

<sup>611</sup> This estimate includes unique dealer-counterparty pairs where the counterparty is another dealer. Excluding dealer-dealer pairs reduces the estimate by 279, with an estimate of 9,332 unique pairs between non-dealer counterparties and dealer accounts with registered office locations in jurisdictions with foreign privacy and secrecy laws, blocking statutes, and other legal barriers (or approximately 70.5% of all unique dealer-counterparty pairs).

Since many of the dealer accounts belong to large financial groups, the Commission can also use the domicile of the parent organization to categorize dealers at the level of the financial group (at the firm-level) instead of at the level of the dealer (at the account-level). Using this more conservative approach, there may be 779 unique dealer-counterparty ties (or 25.7% of all ties) that may be affected by foreign privacy and secrecy laws, blocking statutes, and other legal barriers and the alternative disclosure requirement. The Commission also notes that, as a baseline matter, SBS Entity registration forms are public and the Commission may, in the course of Commission business, publish a list of registered SBS Entities and note the conditional registration status of such entities on the Commission's public website.

The Commission has also considered alternatives providing further relief to SBS Entities with respect to the certification and opinion of counsel requirements. For example, the Commission has also considered lengthening the conditional registration period (to, *e.g.*, 5 or 10 years) in recognition of the fact that some SBS Entities may be unable to provide the requisite certification and opinion of counsel within a 24-month grace period.<sup>612</sup> The Commission also considered eliminating the opinion of counsel requirement and providing carve-outs from the certification for competing blocking, privacy, or secrecy laws, similar to the relief available in swap markets.<sup>613</sup> The Commission could also have eliminated the opinion of counsel requirement and changed the certification to allow a senior officer to certify, based on reasonable due diligence, that the SBS Entity will provide access to its U.S. business-related books and records to the Commission upon request.<sup>614</sup> Finally, the Commission has also considered eliminating the certification and opinion of counsel requirement as a whole.<sup>615</sup>

Relative to the final approach, these alternatives may provide more relief and greater certainty to nonresident entities that may seek to register with the Commission as an SBS Entity. As a result, these alternatives may further decrease the likelihood of disruptions of counterparty relationships and risks of adverse effects on market activity in

security-based swaps. These alternatives would further reduce or eliminate certification and opinion of counsel burdens, related uncertainty, and liability risk. At the same time, as discussed in prior sections, the Commission continues to believe that access to books and records and the ability to inspect and examine registered SBS Entities facilitates Commission oversight of security-based swap markets. These alternatives may limit the scope of assurances provided to the Commission by SBS Entity applicants regarding the Commission's ability to inspect and examine SBS Entities. To the degree that some nonresident SBS Entities may be unable to provide certification or opinion of counsel due to their inability to become subject to Commission inspections and examinations (as a result of, for example, foreign privacy and secrecy laws, blocking statutes, and other legal barriers), these alternatives may reduce the extent of Commission inspections and examinations. Importantly, under the final approach as well as under these alternatives, all nonresident SBS Entities would continue to have independent ongoing obligations to provide the Commission with access to their books and records and to permit onsite inspections and examinations.

## 2. Modifications to Rules 18a-5(a)(10) and (b)(8)

### (a) Costs, Benefits, and Effects on Efficiency, Competition, and Capital Formation

The questionnaire requirement is intended to support Commission oversight and entity compliance with the substantive requirements of Rule 15Fb6 regarding statutory disqualification. The modifications to Rule 18a-5: i) eliminate the questionnaire requirement with respect to associated persons excluded from the statutory prohibition; and ii) modify the questionnaire requirement with respect to associated persons if local law in the jurisdiction where the associated person is located would prohibit the SBS Entity from collecting certain data otherwise required under Rule 18a-5. As discussed above, the Commission received comments supporting the proposed modifications to Rule 18a-5.<sup>616</sup> The Commission continues to believe that these modifications are unlikely to adversely affect Commission oversight of SBS Entity compliance with the statutory prohibition since those associated persons are already excluded from the statutory prohibition. In

addition, the modifications relating to local law still require the SBS Entity to collect those data elements generally required under Rule 18a-5 that the SBS Entity is not prohibited from collecting under local law. At the same time, the modifications may involve modest reductions to corresponding paperwork burdens. The Commission continues to believe that, to the degree that SBS Entities may pass along these burdens to counterparties, the modifications may also result in some benefits to counterparties of these SBS Entities.

As discussed in Part VII.B, the Commission estimates that the addition of paragraphs (a)(10)(iii)(A) and (b)(8)(iii)(A) to Rule 18a-5 would reduce initial costs associated with Rule 18a-5 by \$49,491 and ongoing costs by \$61,335.<sup>617</sup> Therefore, the cost savings to SBS Entities and counterparties from this modification are likely to be modest.

In addition, as discussed above, the Commission is modifying, by adding paragraphs (a)(10)(iii)(B) and (b)(8)(iii)(B), the questionnaire requirement with respect to non-U.S. associated persons of SBS Entities if the receipt of that information, or the creation or maintenance of records reflecting that information, would result in a violation of applicable law in the jurisdiction in which the associated person is employed or located. The primary intended benefit of this modification is to enable certain nonresident SBS Entities to continue intermediating transactions with their counterparties. Specifically, due to the existence of foreign privacy and secrecy laws, blocking statutes, and other legal barriers, the tailoring of the questionnaire requirement can enable more nonresident market participants to register as SBS Entities without a potentially costly relocation or business restructuring of certain operations and records to jurisdictions outside the reach of such laws. This may also reduce costs for counterparties (as nonresident SBS Entities may pass along related costs to counterparties in the form of more expensive security-based swaps) and may preserve valuable counterparty relationships.

In addition, this modification may also involve some modest burden reductions. As discussed in Part VII.B, the modification to add paragraphs (a)(10)(iii)(B) and (b)(8)(iii)(B) to Rule 18a-5 is expected to decrease the initial costs associated with Rule 18a-5 by

<sup>617</sup> Initial cost reduction for all stand-alone and bank SBS Entities reduction:  $(117 \times \text{Attorney at } \$423 \text{ per hour}) = \$49,491$ . Ongoing cost reduction for all stand-alone and bank SBS Entities reduction:  $(145 \times \text{Attorney at } \$423 \text{ per hour}) = \$61,335$ .

<sup>612</sup> See ISDA letter at 10 n.21.

<sup>613</sup> See IIB/SIFMA letter at 20; Credit Suisse/UBS letter at 2; ISDA letter at 10.

<sup>614</sup> *Id.*

<sup>615</sup> See, *e.g.*, EBF letter at 2; ISDA letter at 10; Credit Suisse/UBS letter at 2.

<sup>616</sup> See EBF letter at 6-7; IIB/SIFMA letter at 30.

\$24,534 and ongoing costs by \$30,879.<sup>618</sup> In aggregate, as estimated in Part VIII.B, under both modifications, initial and ongoing costs of all stand-alone and bank SBS Entities related to complying with Rule 18a-5 are estimated at \$215,730 and \$269,874 respectively.<sup>619</sup>

The Commission continues to recognize that certain recordkeeping requirements may facilitate compliance and Commission oversight of SBS Entities. In adopting a tailored questionnaire requirement with respect to non-U.S. associated persons, the Commission has considered the value of such recordkeeping for compliance with Rule 15Fb6-2 and related oversight, as well as the costs and potential disruptions to counterparty relationships and market activity that may result when foreign jurisdictions do not allow nonresident SBS Entities to receive, create, or maintain such records. Importantly, as discussed above, the Commission continues to note that the tailoring of the requirement in (a)(10)(iii)(B) and (b)(8)(iii)(B) does not eliminate or affect the scope of all SBS Entities' ongoing obligations to comply with Section 15F(b)(6) of the Exchange Act and Rule 15Fb6-2, with respect to every associated person that effects or is involved in effecting security-based swaps and is not subject to an exclusion from the statutory disqualification prohibition in Section 15F(b)(6) of the Exchange Act.

Finally, the adopted approach involves a disparate treatment of broker-dealer SBS Entities and stand-alone and bank SBS Entities. Based on an analysis of 2017 TIW data and filings with the Commission, out of 50 participants likely to register with the Commission as security-based swap dealers, the Commission estimates that 16 market participants have already registered with the Commission as broker-dealers; 9 market participants will be stand-alone security-based swap dealers, and up to 25 participants will be bank security-based swap dealers.<sup>620</sup>

<sup>618</sup> Initial cost reduction for all stand-alone and bank SBS Entities reduction:  $(58 \times \text{Attorney at } \$423 \text{ per hour}) = \$24,534$ . Ongoing cost reduction for all stand-alone and bank SBS Entities reduction:  $(73 \times \text{Attorney at } \$423 \text{ per hour}) = \$30,879$ .

<sup>619</sup> Initial costs for all stand-alone and bank SBS Entities reduction under the modifications to Rule 18a-5(a)(10) and (b)(8):  $((700-127-63) \times \text{Attorney at } \$423 \text{ per hour}) = \$215,730$ .

Ongoing costs for all stand-alone and bank SBS Entities reduction:  $((875-158-79) \times \text{Attorney at } \$423 \text{ per hour}) = \$269,874$ .

<sup>620</sup> We note that these figures are based on current market activity in security-based swaps. We are unable to quantify the number of market participants currently expected to register as broker-

Under the modifications, SBS Entities that are not stand-alone or bank SBS Entities would be required to make and keep current a questionnaire or application for employment for associated persons with respect to whom the broker-dealer SBS Entity is excluded from the prohibition in Exchange Act 15F(b)(6), incurring corresponding compliance burdens, albeit modest, estimated above. In addition, to the extent that some SBS Entities that are not stand-alone or bank SBS Entities are heavily reliant on employees in jurisdictions with foreign privacy and secrecy laws, blocking statutes, and other legal barriers in their security-based swap business, they may be unable to comply with the employee questionnaire requirement and register with the Commission. These SBS Entities would be unable to register without a relocation or restructuring of various records and or operations, involving costs for such SBS Entities—costs that may be passed along to counterparties or disrupt existing counterparty relationships. This may reduce the competitive standing of SBS Entities cross-registered as broker-dealers and their employees in certain foreign jurisdictions and improve the competitive standing of stand-alone and bank SBS Entities and their employees in foreign data privacy jurisdictions.

Broker-dealer SBS Entities are already subject to a questionnaire requirement under Rule 17a-3(a)(12). The Commission believes that such entities are making and keeping current employment questionnaires and applications for all of their associated persons in their normal course of business. In addition, the Commission believes that such SBS Entities have already structured their security-based swap business in a manner that would enable them to comply with this requirement without disrupting transaction activity or ongoing counterparty relationships. The sunk cost nature of such structuring of broker-dealers' security-based swap business may partly mitigate the above competitive effects.

#### (b) Alternatives Considered

The Commission has considered an alternative approach, which would provide the same relief (by also amending Rule 17a-3(a)(12) and providing the same relief to broker-dealer SBS Entities) with respect to: (i) Exemption based on the non-U.S.

dealer, bank, or stand-alone security-based swap dealers that may choose to restructure their U.S. security-based swap market participation in response to the pending substantive requirements of Title VII, such as capital and margin requirements.

associated SBS Entity's exclusion from the prohibition under Section 15F(b); and (ii) exemption based on local law.

The alternative would benefit a greater number of SBS Entities and counterparties by extending the relief (with its benefits discussed above) to all SBS Entities in their security-based swap business. Moreover, the alternative would eliminate the competitive disparities between broker-dealer and stand-alone and bank SBS Entities discussed above.

However, the Commission continues to recognize that recordkeeping requirements are essential to the inspection and examination process and facilitate effective oversight of the markets the Commission regulates. Importantly, as discussed above, broker-dealer SBS Entities are already subject to a questionnaire requirement under Rule 17a-3(a)(12). The Commission believes that broker-dealer SBS Entities have already located and structured their security-based swap business in a way that would allow them to comply with the questionnaire requirement. At the same time, the Commission understands that stand-alone and bank SBS Entities active in security-based swap markets are not currently subject to similar recordkeeping requirements and that the questionnaire requirement, as adopted, may require these entities to relocate their security-based swap business and staff to other jurisdictions. This may disrupt counterparty relationships and ongoing business transactions between stand-alone and bank SBS Entities and their customers.

The Commission also understands that broker-dealer SBS Entities are routinely making and keeping current employment questionnaires and applications for all of their associated persons, which may reduce the benefits of the above alternative. However, if such baseline behavior of broker-dealer SBS Entities is a result of Rule 17a-3 currently in effect and not of compliance practices optimal for each broker-dealer SBS Entity, the alternative may reduce burdens<sup>621</sup> and provide beneficial flexibility in recordkeeping practices for broker-dealer SBS Entities with respect to associated persons excluded from the statutory prohibition. The Commission continues to note that the recordkeeping requirement in Rule 18a-5 is intended to support substantive obligations with respect to statutory disqualification and that such substantive obligations would no longer

<sup>621</sup> As acknowledged above, the overall burdens of compliance with Rule 18a-5 are relatively modest; however, fixed costs may be more significant for smaller entities.



exist with respect to associated persons of broker-dealer SBS Entities effecting or involved in effecting security-based swaps and exempt from the statutory prohibition under, for instance, Rule of Practice 194(c)(2).

## VII. Paperwork Reduction Act

Certain provisions of the amendments to Exchange Act Rules 3a71–3 and 18a–5 contain “collection of information”<sup>622</sup> requirements within the meaning of the Paperwork Reduction Act of 1995 (“PRA”). The Commission published notice requesting comment on the collection of information requirements<sup>623</sup> and submitted the proposed collections of information to the Office of Management and Budget (“OMB”) for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. The Commission’s earlier PRA assessments have been revised to reflect the modifications to the rule amendments from those that were proposed, as well as additional information and data now available to the Commission. 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 OMB control number.

The title of the new collection of information associated with the amendments to Rule 3a71–3 is “Rule 3a71–3(d)—Conditional Exception from *De Minimis* Counting Requirement in Connection with Certain Transactions Arranged, Negotiated, or Executed in the United States,” OMB Control Number 3235–0771.<sup>624</sup> The title and OMB control number for the collection of information the Commission is proposing to modify is “Rule 18a–5—Records to be made by certain security-based swap dealers and major security-based swap participants,” OMB Control Number 3235–0745.

In the Proposing Release, the Commission requested comment on the collection of information requirements contained therein, as well as the accuracy of the Commission’s related estimates and statements regarding the associated costs and burdens of the proposed rules. The Commission did not receive any comments on these matters. The Commission continues to believe that the methodology used for

calculating the burdens set forth in the Proposing Release is appropriate. However, where noted, certain estimates have been modified, as necessary, to conform to the adopted rules and to reflect the most recent data available to the Commission. Other than these changes, the Commission’s estimates remain unchanged from those in the Proposing Release.

### A. Amendment to Rule 3a71–3

#### 1. Summary of the Collection of Information<sup>625</sup>

##### (a) Notification of Limited Title VII Applicability

The exception to Rule 3a71–3 is conditioned in part on the registered entity engaged in arranging, negotiating, or executing activity in the United States notifying the counterparties of the non-U.S. person relying on the exception, contemporaneously with and in the same manner as the arranging, negotiating, or executing activity, that the non-U.S. person is not registered with the Commission as a security-based swap dealer, and that certain Exchange Act provisions or rules addressing the regulation of security-based swaps would not be applicable in connection with the transaction.<sup>626</sup> As discussed in Part II.C.4, the Commission is adopting an alternative means of satisfying this notification condition. As amended, the condition allows a single disclosure to cover all subsequent arranging, negotiating, or executing activity of a registered entity that has no customer relationship with the counterparty. This notification condition applies only when the identity of the counterparty is known to the registered entity at a reasonably sufficient time prior to the execution of the transaction to permit the disclosure.<sup>627</sup>

<sup>625</sup> Because the amendment to Rule 3a71–3 would require the use of a registered entity in connection with the transactions at issue, the amendment also would implicate collections of information associated with security-based swap dealer and/or broker status (apart from the collections associated with the specific conditions of the exception). Separate collections of information address the registration of security-based swap dealers and/or brokers, as well as the requirements associated with those registered entities as a matter of course, including recordkeeping requirements applicable to such registered entities. The separate collections of information associated with requirements of general applicability for registered security-based swap dealers and/or brokers are not addressed as part of this rulemaking, and instead are addressed by the collections of information associated with those separate requirements.

<sup>626</sup> See Exchange Act Rule 3a71–3(d)(1)(iv).

<sup>627</sup> See *id.*

##### (b) Business Conduct-Related Conditions

The exception to Rule 3a71–3 is conditioned in part on the registered entity that engages in arranging, negotiating, or executing activity in the United States in connection with the transactions at issue complying with certain security-based swap dealer business conduct requirements related to disclosure of material risks, characteristics, incentives, and conflicts of interest; suitability of recommendations; and fair and balanced communications. The registered entity must comply with these requirements as if the counterparty to the non-U.S. person relying on the exception also were a counterparty to that registered entity and, if the registered entity is a broker not registered as a security-based swap dealer, also as if it were a registered security-based swap dealer.<sup>628</sup> Each of those underlying business conduct requirements itself is associated with a collection of information.<sup>629</sup> The Commission is adopting the disclosure condition and the communications condition as proposed, and is adopting an alternative method to satisfy the counterparty-specific prong of the suitability condition. First, the registered entity could ensure that it has a reasonable basis to believe that the recommended security-based swap or strategy involving a security-based swap is suitable for the counterparty, as required by Rule 15Fh–3(f)(1). Alternatively, if the registered entity reasonably determines that the counterparty to whom it recommends a security-based swap or trading strategy involving a security-based swap is an “institutional counterparty” as defined in Rule 15Fh–3(f)(4), the registered entity instead may disclose to the counterparty that it is not undertaking to assess the suitability of the security-based swap or trading strategy involving a security-based swap for the counterparty.

##### (c) Trade Acknowledgment and Verification Condition

The exception to Rule 3a71–3 is conditioned in part on the registered entity that engages in arranging, negotiating, or executing activity in the United States in connection with the

<sup>628</sup> See Exchange Act Rule 3a71–3(d)(1)(ii)(B)(1)–(3).

<sup>629</sup> See Business Conduct Adopting Release, 81 FR at 30083–85 (discussing collections of information regarding security-based swap dealer requirement for disclosure of information regarding material risks, characteristics, incentives and conflicts of interest, suitability of recommendations, and fair and balanced communications).

<sup>622</sup> 44 U.S.C. 3502(3).

<sup>623</sup> See Proposing Release, 84 FR at 24288–89.

<sup>624</sup> This new collection of information is distinct from an existing collection of information related to Exchange Act Rule 3a71–3(c), which provides an exception from the application of certain business conduct requirements in connection with a security-based swap dealer’s “foreign business.” See *generally* Business Conduct Adopting Release, 81 FR at 30082.

transactions at issue complying with trade acknowledgment and verification requirements. These requirements themselves are associated with collections of information.<sup>630</sup> The registered entity must comply with these requirements as if the counterparty to the non-U.S. person relying on the exception also were a counterparty to that registered entity and, if the registered entity is a broker not registered as a security-based swap dealer, also as if it were a registered security-based swap dealer.<sup>631</sup>

(d) Portfolio Reconciliation Condition

The Commission proposed that the exception to Rule 3a71–3 be conditioned in part on registered entity that engages in arranging, negotiating, or executing activity in the United States in connection with the transactions at issue complying with certain portfolio reconciliation requirements.<sup>632</sup> As discussed in Part II.C.2, the Commission is persuaded by comments that the burdens of compliance with the proposed condition would outweigh its benefits, and is not adopting the condition.

(e) Recordkeeping Condition

The exception to Rule 3a71–3 is conditioned in part on the registered entity engaged in arranging, negotiating, or executing activity in the United States obtaining from the non-U.S. person relying on the exception, and maintaining for not less than three years following the activity subject to the exception, the first two years in an easily accessible place, trading relationship documentation involving the counterparty to the transaction.<sup>633</sup>

<sup>630</sup> See Trade Acknowledgment and Verification Adopting Release, 81 FR at 39829–30 (discussing collections of information regarding security-based swap dealers requirement for trade acknowledgment and verification).

<sup>631</sup> See Exchange Act Rule 3a71–3(d)(1)(ii)(B)(4).

<sup>632</sup> See proposed Exchange Act Rule 3a71–3(d)(1)(ii)(B)(5).

<sup>633</sup> See Exchange Act Rule 3a71–3(d)(1)(iii)(B)(3).

In addition, the exception is conditioned in part on the registered entity creating and maintaining books and records relating to the transactions subject to this exception that are required, as applicable, by Rules 17a–3 and 17a–4, or Rules 18a–5 and 18a–6, including books and records relating to: Disclosure of risks, characteristics, incentives, and conflicts; assessment of suitability; fair and balanced communications; and trade acknowledgment and verification. See Exchange Act Rule 3a71–3(d)(1)(iii)(B) (requiring creation and maintenance of books and records relating to the requirements specified in proposed paragraph (d)(1)(ii)(B)).

Because that part of the condition subsumes the collection of information that the Commission would expect to be associated with the final rules adopting those security-based swap dealer books and records requirements, it does not constitute a separate collection of information attributable to this exception. See note 624, *supra*.

(f) Consent to Service Condition

The exception to Rule 3a71–3 is conditioned in part on the registered entity engaged in arranging, negotiating, or executing activity in the United States obtaining from the non-U.S. person relying on the exception, and maintaining for not less than three years following the activity subject to the exception, the first two years in an easily accessible place, written consent to service of process for any civil action brought by or proceeding before the Commission, providing that process may be served on the non-U.S. person by service on the registered entity in the manner set forth in the registered entity's current Form BD, SBSE, SBSE–A or SBSE–BD, as applicable.<sup>634</sup>

(g) “Listed Jurisdiction” Condition

The exception to Rule 3a71–3 is conditioned in part on the non-U.S. person relying on the exception being subject to the margin and capital requirements of a “listed jurisdiction.”<sup>635</sup> The Commission may issue an order designating a jurisdiction on its own initiative or in response to applications by persons that may rely on the exception, or by foreign financial authorities, which must be filed pursuant to the procedures set forth in Exchange Act Rule 0–13.<sup>636</sup>

(h) Risk Management Control System Condition

The exception to Rule 3a71–3 is conditioned in part on certain registered entities engaged in arranging, negotiating, or executing activity in the United States complying with portions of Exchange Act Rule 15c3–4 even though they would not otherwise be required to do so.<sup>637</sup> Rule 15c3–4

<sup>634</sup> See Exchange Act Rule 3a71–3(d)(1)(iii)(B)(4).

<sup>635</sup> See Exchange Act Rule 3a71–3(d)(1)(v).

<sup>636</sup> See Exchange Act Rule 3a71–3(d)(2)(i).

<sup>637</sup> See Exchange Act Rule 3a71–3(d)(1)(i)(B)(2) (requiring compliance with Exchange Act Rule 15c3–1(a)(10)), which in turn requires compliance with portions of Exchange Act Rule 15c3–4, when the registered entity is a broker not approved to use models to compute deductions for market or credit risk). A broker not approved to use models to compute deductions for market or credit risk is not subject to Rule 15c3–4 unless it is also a security-based swap dealer or an OTC derivatives dealer. The condition to the exception requiring such brokers to comply with Rule 15c3–1(a)(10) thus imposes a new requirement to comply with portions of Rule 15c3–4. Other registered entities—brokers who are approved to use models, non-model brokers who are dually registered as a security-based swap dealer or an OTC derivatives dealer, and stand-alone security-based swap dealers—are already required to comply with Rule 15c3–4. See Exchange Act Rule 15c3–1(a)(7) (requiring brokers approved to use models to comply with portions of Exchange Act Rule 15c3–4); Exchange Act Rule 15c3–1(a)(10) (requiring brokers not approved to use models who are dually

requires the establishment of an internal risk management control system and involves each entity documenting, recording, and maintaining its system of internal risk management controls.

(i) Conditions Associated With the Use of Exception for Covered Inter-Dealer Security-Based Swaps

The use of the exception to Rule 3a71–3 for covered inter-dealer security-based swaps is conditioned in part on the registered entity engaged in arranging, negotiating, or executing activity in the United States complying with a number of requirements: (1) Filing with the Commission a notice that its associated persons may conduct “arranging, negotiating, or executing” activity in the United States; and (2) obtaining from the non-U.S. person relying on the exception, and maintaining, documentation regarding such non-U.S. person's compliance with the inter-dealer threshold.

2. Use of Information

(a) Notification of Limited Title VII Applicability

The notification condition is intended to help guard against counterparties reasonably presuming that the involvement of U.S. personnel in an arranging, negotiating, or executing capacity as part of the transaction would be accompanied by the safeguards associated with Title VII security-based swap dealer regulation applying to the non-U.S. person.

(b) Business Conduct-Related Conditions

The use of the information associated with the business conduct condition is the same as the use of information associated with the currently extant security-based swap dealer business conduct requirements. These conditions apply the existing requirements to transactions that, without the exception to Rule 3a71–3, would have counted against the *de minimis* threshold and could have caused the non-U.S. entity relying on the exception to register as a security-based swap dealer and comply with similar or more stringent business conduct requirements. The condition requiring the registered entity to comply with requirements for the disclosure of risks, characteristics, incentives, and conflicts will assist the counterparty in assessing the transaction by providing it

registered as security-based swap dealers to comply with portions of Exchange Act Rule 15c3–4; Exchange Act Rule 15c3–4 (requiring compliance by OTC derivatives dealers); Exchange Act Rule 18a–1(f) (requiring security-based swap dealers to comply with portions of Exchange Act Rule 15c3–4).

with a better understanding of the expected performance of the security-based swap, and provide additional transparency and insight into pricing.<sup>638</sup> The condition requiring the registered entity to comply with requirements regarding the suitability of recommendations will assist the registered entity in making appropriate recommendations.<sup>639</sup> The condition requiring the registered entity to comply with fair and balanced communication requirements in part better equip the counterparty to make more informed investment decisions.<sup>640</sup>

#### (c) Trade Acknowledgment and Verification Condition

The use of the information associated with the trade acknowledgment and verification condition is the same as the use of information associated with the currently extant security-based swap dealer trade acknowledgment and verification requirements. The condition applies the existing requirements to transactions that, without the exception to Rule 3a71–3, would have counted against the *de minimis* threshold and could have caused the non-U.S. entity relying on the exception to register as a security-based swap dealer and comply with the same trade acknowledgment and verification requirements. In general, the trade acknowledgment serves as a written record by which the counterparties to the transaction may memorialize the terms of a transaction, and the verification requirements ensure that the written record of the transaction accurately reflects the terms of the transaction as understood by the respective counterparties.<sup>641</sup>

#### (d) Recordkeeping Condition

The condition requiring the registered entity to obtain and maintain trading relationship documentation involving the non-U.S. person relying on the exception and its counterparty is intended to help the Commission obtain a full view of the dealing activities connected with transactions relying on the exception, including such activities that occur in the non-U.S. person relying on the exception. Absent such access, the Commission may be impeded in identifying fraud and abuse in connection with transactions that have been arranged, negotiated, or executed in the United States, where such fraud or abuse may be apparent only in light of relevant information

obtained from the non-U.S. person relying on the exception or its associated persons.

#### (e) Consent to Service Condition

The use of the consent to service condition is to facilitate the Commission's ability to serve process on the non-U.S. person relying on the exception, which in turn will assist the Commission in efficiently taking action to address potential violations of the federal securities laws in connection with the transactions at issue.

#### (f) "Listed Jurisdiction" Condition

The use of information provided by applicants in connection with "listed jurisdiction" applications is to assist the Commission in evaluating the effectiveness of the financial responsibility requirements of jurisdictions regulating non-U.S. persons relying on the exception. This condition is intended to help avoid creating an incentive for persons engaged in a security-based swap dealing business in the United States to book their transactions into entities that solely are subject to the regulation of jurisdictions that do not effectively require security-based swap dealers or comparable entities to meet certain financial responsibility standards. Avoiding such an incentive should help prevent creating an unwarranted competitive advantage to non-U.S. persons that conduct security-based swap dealing activity in the United States without being subject to strong financial responsibility standards. The condition also is consistent with the view that applying financial responsibility requirements to such transactions between two non-U.S. persons can help mitigate the potential for financial contagion to spread to U.S. market participants and to the U.S. financial system more generally.

#### (g) Risk Management Control System Condition

Compliance with Rule 15c3–4 by the registered entity engaged in arranging, negotiating, or executing activity in the United States is intended to promote the establishment and maintenance of an effective risk management control system by such entities.

#### (h) Conditions Associated With the Use of Exception for Covered Inter-Dealer Security-Based Swaps

The use of information provided by applicants in connection with the notice and compliance documentation requirements associated with the use of the conditional exception for covered inter-dealer security-based swaps is to

assist the Commission in evaluating compliance with the limitations on such use of the exception.

### 3. Respondents

As discussed above, the Commission continues to estimate that up to 24 entities that engage in security-based swap dealing activity may rely on the conditional exception from having to count dealing transactions with non-U.S. counterparties against the *de minimis* thresholds.<sup>642</sup> To satisfy the exception, each of those up to 24 entities will make use of an affiliated registered entity that will be required to comply with—and incur collections of information in connection with—conditions related to compliance with certain Title VII security-based swap dealer requirements related to business conduct and trade acknowledgment and verification. Each of those up to 24 registered entities also will have to provide disclosures to counterparties of the non-U.S. persons relying on the exception, to obtain and maintain trading relationship documentation involving the non-U.S. persons relying on the exception and their counterparties, and to comply with the condition that the registered entity obtain from the non-U.S. person a consent to service of process.

The Commission estimates that up to 24 entities will make use of the exception for covered inter-dealer security-based swaps. To satisfy the exception, each of those up to 24 entities will make use of an affiliated registered entity that will be required to comply with the notice and compliance documentation requirements associated with the use of the exception for covered inter-dealer security-based swaps.

The Commission is unable to estimate how many of the 24 non-U.S. relying entities will make use of a registered broker that is not approved to use

<sup>642</sup> This estimate is based on data (see Part VI.A.7, *supra*) indicating that: (1) Six U.S. entities are engaged in security-based swap dealing activity above the *de minimis* thresholds may have the incentive to book future security-based swaps with non-U.S. counterparties into U.S. affiliates to make use of the proposed exception in connection with those transactions. (2) One non-U.S. entity would fall below the \$3 billion *de minimis* threshold if its transactions with non-U.S. counterparties were not counted. (3) The "arranged, negotiated, or executed" counting standard would result in five additional non-U.S. entities incurring assessment costs in connection with the *de minimis* exception.

The analysis has doubled those numbers—to up to twelve U.S. persons that may change its booking practices involving security-based swaps to make use of the exception, plus up to twelve additional non-U.S. persons—to address potential growth of the security-based swap market and to account for uncertainty associated with the availability of data, leading to the final estimate of 24 entities. See *id.*

<sup>638</sup> See Business Conduct Adopting Release, 81 FR at 30088.

<sup>639</sup> See *id.*

<sup>640</sup> See *id.*

<sup>641</sup> See Trade Acknowledgment and Verification Adopting Release, 81 FR at 39830.

models to compute deductions for market or credit risk, and is therefore required to maintain minimum net capital equivalent to that of a security-based swap dealer not approved to use models and establish and maintain risk management control systems as if the entity were a security-based swap dealer. For purposes of calculating burdens associated with establishing and maintaining a risk management control system, the Commission estimates that up to 24 non-U.S. relying entities will make use, for purposes of the exception, of a registered broker that is not approved to use models to compute deductions for market or credit risk.

Applications for listed jurisdiction determinations may be submitted by the up to 24 non-U.S. persons that will rely on the exception. In practice the Commission expects that the greater portion of such listed jurisdiction applications will be submitted by foreign financial authorities, given their expertise in connection with the relevant financial responsibility requirements, information access provisions, and supervisory and enforcement oversight with regard to the financial responsibility requirements.<sup>643</sup>

#### 4. Total Annual Reporting and Recordkeeping Burdens (Summarized in Table 6)

##### (a) Notification of Limited Title VII Applicability

The Commission continues to estimate that up to 12 U.S. entities may book transactions into their non-U.S. affiliates to make use of the conditional exception and in the aggregate would annually engage in nearly 76,000 security-based swap dealing transactions with non-U.S. counterparties.<sup>644</sup> Here—and in connection with the other two groups addressed below—the analysis doubles that amount to estimate the number of total notifications, recognizing that there will be situations in which the registered entity engaged in arranging, negotiating, or executing activity in the United States makes the required

notifications but a transaction does not result.<sup>645</sup>

The Commission also continues to estimate that two non-U.S. persons may fall below the *de minimis* thresholds due to the conditional exception and in the aggregate would annually engage approximately 20,000 security-based swap dealing transactions with non-U.S. counterparties.<sup>646</sup> doubled here to account for notices that are not followed by a transaction.<sup>647</sup>

The Commission further continues to estimate that an additional ten non-U.S. entities may rely on the conditional exception and in the aggregate would annually engage in approximately 2,100 security-based swap dealing transactions, with non-U.S. persons, that may be subject to the exception,<sup>648</sup> doubled here to account for notices that are not followed by a transaction.<sup>649</sup>

In light of the limited contents of those notices, the Commission continues to believe that each such notice on average would be expected to take no more than five minutes. Accordingly, the Commission continues to estimate that the 12 U.S. entities that may book transactions into their non-U.S. affiliates to make use of the conditional exception in the aggregate will annually spend a total of approximately 12,609 hours to provide the notices required by the conditions.<sup>650</sup> The alternative means of satisfying this condition through a single notice, discussed in Part II.C.4 above, does not alter the burden estimates for these 12 U.S. entities because the single disclosure is not available when the counterparty is a customer or security-based swap counterparty of the registered entity, and it is likely that the 12 U.S. entities

described above would make use of the exception with respect to “arranging, negotiating, or executing” activity for its own customers and counterparties. The Commission further continues to estimate that the two non-U.S. entities that may fall below the *de minimis* thresholds due to the exception in the aggregate will annually spend a total of approximately 3,355 hours to provide the disclosures required by the conditions,<sup>651</sup> while the other ten non-U.S. entities that may rely on the conditional exception in the aggregate will annually spend a total of approximately 352 hours to provide the disclosures required by the conditions.<sup>652</sup> However, the Commission is unable to estimate how many of these non-U.S. entities would be able to rely on the single disclosure, and therefore, for purposes of calculating reporting and recordkeeping burdens, the Commission estimates that none of these entities would rely on the single disclosure.

The Commission also continues to believe that each of those 24 total entities would initially spend 100 hours and incur approximate costs of \$30,598 to develop policies and procedures to help ensure that appropriate disclosures are provided.<sup>653</sup>

##### (b) Business Conduct-Related Conditions

The Commission estimated the reporting and recordkeeping burdens associated with the relevant security-based swap dealer business conduct requirements under Title VII when it adopted those requirements. The Commission continues to believe that those estimates are instructive for calculating the per-entity reporting and recordkeeping burdens associated with the business conduct-related conditions, given that the conditions in effect would require compliance with those business conduct requirements.

##### • Disclosures of material risks, characteristics, and conflicts and

<sup>651</sup> 40,256 aggregate annual disclosures × 5 minutes per transaction. This averages to approximately 1,677 hours for each of those two firms.

<sup>652</sup> 4,224 aggregate annual disclosures × 5 minutes per transaction. This averages to 35.2 hours for each of those ten firms.

<sup>653</sup> Applied to the estimated 24 entities at issue here, this would amount to 2,400 hours and \$734,352.

These estimates are based on prior estimates, made in connection with the adoption of the “arranged, negotiated, or executed” counting standard, that non-U.S. persons would incur 100 hours and \$28,300 to establish policies and procedures to restrict communications with U.S. personnel in connection with the non-U.S. persons’ dealing activity. See ANE Adopting Release, 81 FR at 8628. That \$28,300 estimate has been adjusted to \$30,598 in current dollars (28,300 × 1.0812).

<sup>643</sup> As discussed below, the Commission estimates that three non-U.S. persons will submit listed jurisdiction applications.

<sup>644</sup> Available data indicates that the six U.S. entities that are engaged in security-based swap dealing activity above the *de minimis* thresholds in the aggregate annually engage in 37,827 transactions with non-U.S. counterparties. To address potential growth in the market and data-related uncertainty, the analysis doubles that estimate to 75,654 transactions annually (and also doubles the estimated number of entities).

<sup>645</sup> This produces an estimate of 151,308 (75,654 × 2) annual disclosures pursuant to the condition.

<sup>646</sup> Available data indicates that the one non-U.S. entity that would fall below the *de minimis* thresholds due to the exception annually engages in 10,064 transactions with non-U.S. counterparties. To address potential growth in the market and data-related uncertainty, the analysis doubles that estimate to 20,128 transactions annually (and also doubles the estimated number of entities).

<sup>647</sup> This produces an estimate of 40,256 (20,128 × 2) annual disclosures pursuant to the condition.

<sup>648</sup> Available data indicates that would result in five additional non-U.S. persons that would be expected to incur assessment costs due to the “arranged, negotiated, or executed” counting standard engage in a total of 1,056 annual security-based swap transactions with non-U.S. counterparties. To address potential growth in the market and data-related uncertainty, the analysis doubles that estimate to 2,112 transactions annually (and also doubles the estimated number of entities).

<sup>649</sup> This produces an estimate of 4,224 (2,112 × 2) annual disclosures pursuant to the condition.

<sup>650</sup> 151,308 aggregate annual disclosures × 5 minutes per transaction. This averages to approximately 1,050.75 hours for each of those 12 firms.

*incentives.* When the Commission earlier considered the compliance burdens associated with those disclosure requirements (along with clearing rights and daily mark disclosure requirements not applicable under this exception),<sup>654</sup> the Commission estimated that implementation of those requirements: (i) Initially would require three persons from trading and structuring, three persons from legal, two persons from operations, and four persons from compliance, for 100 hours each;<sup>655</sup> (ii) half of those persons would be required to spend 20 hours annually to re-evaluate and modify disclosures and systems requirements;<sup>656</sup> and (iii) those entities would require eight full-time persons for six months of systems development, programming, and testing,<sup>657</sup> along with two full-time persons annually for maintenance of this system.<sup>658</sup>

• *Suitability of recommendations.* When the Commission previously analyzed the burdens associated with the security-based swap dealer recommendation suitability requirement, it estimated that most security-based swap dealers would obtain representations from counterparties to comply with the institutional counterparty suitability provisions of the requirement.<sup>659</sup> The Commission further particularly

estimated: (i) That for security-based swap market participants that also are swap market participants, most of the requisite representations have been drafted for the swaps context, and that to the extent that any modifications are necessary to adapt those representations to the security-based swap context, each market participant would require two hours to assess the need for modifications and make any required modifications;<sup>660</sup> and (ii) other market participants (apart from special entities not relevant here) would require five hours for each market participant to review and agree to the relevant representations.<sup>661</sup> The suitability condition that the Commission is adopting lessens the institutional counterparty suitability requirements, upon which this prior analysis was based, in connection with transactions subject to the exception. Accordingly, when complying with the institutional counterparty suitability requirements, the registered entity does not have to obtain representations or other information demonstrating that the counterparty or its agent is capable of independently evaluating investment risks with regard to the security-based swap or trading strategy involving a security-based swap, nor must it obtain representations that the counterparty or agent is exercising independent judgment in evaluating the registered entity's recommendations. To reflect this reduced reporting and recordkeeping burden, the Commission estimates: (i) That for registered entities that also are swap market participants, most of the requisite representations have been drafted for the swaps context, and to the extent that any modifications are necessary to adapt those representations to the context of the suitability condition, each market participant would require one hour<sup>662</sup> to assess the need for modifications and make any required modifications;<sup>663</sup>

and (ii) other market participants (apart from special entities not relevant here) would require two and a half hours<sup>664</sup> for each market participant to review and agree to the relevant representations.<sup>665</sup>

• *Fair and balanced communications.* The Commission's earlier analysis of the burdens associated with the fair and balanced communications requirement<sup>666</sup> took the view that each registered entity would incur: (i) \$6,000 in initial legal costs to draft or review statements of potential opportunities and corresponding risks in marketing materials;<sup>667</sup> (ii) an additional initial six hours for internal review of other communications such as emails and Bloomberg messages;<sup>668</sup> and (iii) \$8,400 in initial legal costs associated with marketing materials for more bespoke transactions.<sup>669</sup>

executed" counting standard in the aggregate have six unique non-U.S. counterparties that are swap market participants, and one unique non-U.S. counterparty that is not a swap market participant. Adding together those estimates and then doubling them (in light of the uncertainty associated with the estimate and to account for potential growth of the security-based swap market) produces a total estimate of 1,116 unique non-U.S. counterparties that are swap market participants, and 498 that are not. Only non-U.S. counterparties are relevant for purposes of this analysis because the proposed exception does not address security-based swap transactions involving U.S. person counterparties.

Consistent with these assumptions, the potential burden associated with such modifications in connection with the proposed condition would amount to 1,116 hours (1,116 non-U.S. security-based swap market participants that also are swap market participants  $\times$  1 hour).

<sup>664</sup> The Commission previously estimated that other market participants would require five hours for each market participant to perform this task in connection with the more stringent suitability requirements described above. See Business Conduct Adopting Release, 81 FR at 30092.

<sup>665</sup> Consistent with the above assumptions, the burden associated with such modifications in connection with the condition would amount to 1,245 hours (498 non-U.S. security-based swap market participants that are not also swap market participants  $\times$  2.5 hours).

<sup>666</sup> See Business Conduct Adopting Release, 81 FR at 30093.

<sup>667</sup> In connection with the exception, the potential burden associated with such drafting or review would amount to \$155,693 (24 entities  $\times$  \$6,000  $\times$  1.0812 adjustment to current dollars).

<sup>668</sup> In connection with the exception, the potential burden associated with such internal review would amount to 144 hours (24 entities  $\times$  6 hours).

<sup>669</sup> In connection with the exception, the potential burden associated with such drafting or review would amount to \$217,970 (24 entities  $\times$  \$8,400  $\times$  1.0812 adjustment to current dollars).

In adopting the fair and balanced communication requirement, the Commission also incorporated an estimate of ongoing compliance costs (associated with review of email communications sent to counterparties) over the term of the security-based swap. See Business Conduct Adopting Release, 81 FR at 30093. Those costs are not incorporated into this estimate because the registered entity that engaged in market-facing activity in the United States in connection with the transactions at issue

<sup>654</sup> See Business Conduct Adopting Release, 81 FR at 30091–92. In connection with those prior estimates, the Commission noted that entities that are dually registered with the CFTC already provide their counterparties with similar disclosures.

<sup>655</sup> Applied to the 24 entities at issue here, this would amount to an aggregate initial burden of 28,800 hours (24 entities  $\times$  12 persons  $\times$  100 hours).

<sup>656</sup> Applied to the 24 entities at issue here, this would amount to an aggregate annual burden of 2,880 hours (24 entities  $\times$  6 persons  $\times$  20 hours).

<sup>657</sup> Applied to the 24 entities at issue here, this would amount to an aggregate initial burden of 192,000 hours (24 entities  $\times$  8 persons  $\times$  1,000 hours).

<sup>658</sup> Applied to the 24 entities at issue here, this would amount to an aggregate annual burden of 96,000 hours (24 entities  $\times$  2 persons  $\times$  2,000 hours).

In adopting those disclosure requirements, the Commission also incorporated an estimate of one hour per security-based swap for an entity to evaluate whether more particularized disclosures are necessary and to develop additional disclosures. See Business Conduct Adopting Release, 81 FR at 30092. The Commission does not believe that particular category of costs would be applicable in the context of the transactions at issue here.

Under the exception, the disclosure condition extends not only to incentives and conflicts of the registered entity, but also incentives and conflicts of its non-U.S. affiliate. The Commission believes, however, that the existing burden estimates are sufficient to account for this aspect of the disclosure, given that the two entities' affiliation should facilitate the transfer of any relevant incentive and conflict information for the registered entity to convey.

<sup>659</sup> See *id.* at 30092–93.

<sup>662</sup> The Commission previously estimated that, for security-based swap market participants that also are swap market participants, each market participant would require two hours perform this task in connection with the more stringent suitability requirements described above. See Business Conduct Adopting Release, 81 FR at 30092.

<sup>663</sup> Analysis of current data indicates that six U.S. entities engaged in security-based swap dealing activity above the *de minimis* thresholds in the aggregate have 161 unique non-U.S. counterparties that are swap market participants, and 70 unique non-U.S. counterparties that are not swap market participants. One non-U.S. entity may fall below the *de minimis* threshold due to the exception and has 391 unique non-U.S. counterparties that are swap market participants, and 178 unique non-U.S. counterparties that are not swap market participants. Five additional non-U.S. persons would be expected to incur assessment costs in connection with the "arranged, negotiated, or

## (c) Trade Acknowledgment and Verification Condition

The Commission estimated the reporting and recordkeeping burdens associated with the trade acknowledgment and verification requirements under Title VII when it adopted those requirements.<sup>670</sup> The Commission continues to believe that those estimates are instructive for calculating the per-entity reporting and recordkeeping burdens associated with the trade acknowledgment and verification condition, given that the condition in effect would require compliance with that trade acknowledgment and verification requirement by additional persons and/or in additional circumstances.

When the Commission earlier considered the compliance burdens associated with the trade acknowledgment and verification requirements, the Commission estimated that each applicable entity would incur: (i) 355 Hours initially to develop an internal order and trade management system;<sup>671</sup> (ii) 436 hours annually for day-to-day technical support, as well as amortized annual burden associated with system or platform upgrades and updates;<sup>672</sup> (iii) 80 hours initially for the preparation of written policies and procedures to obtain verification of transaction terms;<sup>673</sup> and (iv) 40 hours annually to maintain those policies and procedures.<sup>674</sup>

## (d) Recordkeeping Condition

To comply with the recordkeeping conditions relating to trading relationship documentation, the registered entity and the non-U.S. person relying on the exception jointly would need to develop policies and procedures to provide for the identification of such records and for their transfer to the registered affiliate. For each use of the exception, the Commission continues to estimate that

here would not be expected to have ongoing communications with the counterparty to the security-based swap.

<sup>670</sup> See *id.* at 39830–31.

<sup>671</sup> In connection with the exception, the potential burden associated with such system development would amount to 8,520 hours (24 entities × 355 hours).

<sup>672</sup> In connection with the exception, the potential annual burden associated with such support and updates would amount to 10,464 hours (24 entities × 436 hours).

<sup>673</sup> In connection with the exception, the potential burden associated with such preparation would amount to 1,920 hours (24 entities × 80 hours).

<sup>674</sup> In connection with the exception, the potential annual burden associated with such policies and procedures would amount to 960 hours (24 entities × 40 hours).

such policies and procedures would impose a one-time initial burden of 20 hours.<sup>675</sup>

The Commission also continues to estimate that the non-U.S. person relying on this exception also would need to expend two hours per week to identify such records and to electronically convey the records to its registered affiliate.<sup>676</sup> The Commission further continues to estimate that the registered affiliate would need to expend one hour per week in connection with the receipt and maintenance of those records and the records related to the consent to service condition described below.<sup>677</sup>

## (e) Consent To Service Condition

To comply with the condition that the affiliated registered entity obtain from the non-U.S. person relying on the exception, and maintain for not less than three years following the activity subject to the exception, the first two years in an easily accessible place, written consent to service of process for civil actions, one or the other of those parties would have to draft such a consent or use an industry-standard consent provision, and the registered entity must obtain that consent from the non-U.S. person. The Commission continues to estimate that the parties jointly must expend two hours in connection with obtaining this consent.<sup>678</sup> The burden associated with the registered entity's maintenance of records related to the consent to service condition are included in the Commission's estimate of the burden associated with the registered entity's maintenance of records related to the recordkeeping provisions.<sup>679</sup>

<sup>675</sup> Across the 24 potential uses of the exception, this would amount to a total of 480 hours (24 entities × 20 hours).

<sup>676</sup> Across the 24 potential uses of the exception, this would amount to a total of 2,496 hours annually (24 entities × 2 hours × 52 weeks).

<sup>677</sup> Across the 24 potential uses of the exception, this would amount to a total of 1,248 hours annually (24 entities × 1 hour × 52 weeks).

The recordkeeping condition also specifies that, for the exception to be available, the registered entity must create and maintain books and records as required by applicable rules, including any books and records requirements relating to the provisions specified in paragraph (d)(1)(ii)(B) (*i.e.*, relating to disclosure of risks, characteristics, incentives, and conflicts; suitability; fair and balanced communications; and trade acknowledgment and verification). Because that part of the condition subsumes the collection of information that we would expect to be associated with the final rules adopting those security-based swap dealer books and records requirements, it does not constitute a separate collection of information. See note 624, *supra*.

<sup>678</sup> Across the 24 expected uses of the exception, this would amount to a total of 48 hours (24 entities × 2 hours).

<sup>679</sup> See note 677, *supra*.

## (f) “Listed Jurisdiction” Condition

The Commission continues to believe that burden estimates associated with applications for substituted compliance determinations are instructive with regard to the burdens that would be associated with applications by market participants in connection with “listed jurisdiction” status.<sup>680</sup>

When the Commission initially adopted Rules 0–13 and 3a71–6, providing for substituted compliance in connection with security-based swap dealer business conduct requirements, the Commission concluded that the “great majority” of substituted compliance applications would be submitted by foreign authorities, and that “very few” applications would be submitted by SBS Entities, and the Commission concluded that three such registered entities would submit substituted compliance applications.<sup>681</sup> The Commission further estimated that the one-time paperwork burden associated with preparing and submitting all three substituted compliance requests in connection with those requirements would be approximately 240 hours, plus \$240,000 for the services of outside professionals.<sup>682</sup> The Commission subsequently relied on those estimates in connection with the paperwork burdens associated with amendments to Rule 3a71–6 related to trade acknowledgment and verification.<sup>683</sup>

The Commission similarly believes that the majority of “listed jurisdiction” applications would be made by foreign authorities rather than by the up to 24 non-U.S. persons that potentially would rely on the exception. Consistent with the estimates in connection with the substituted compliance rule, moreover, the Commission estimates that three non-U.S. persons that seek to rely on the exception would file listed jurisdiction applications, and that in the aggregate those three persons would incur initial paperwork burdens, associated with preparing and submitting the requests, of approximately 240 hours, plus \$259,488 for the services of outside

<sup>680</sup> Notwithstanding the substantive differences between the standards associated with listed jurisdiction determinations and substituted compliance assessments, see Part II.C.5, *supra*, the two sets of applications will be submitted pursuant to Rule 0–13 and may be expected to address certain analogous elements.

<sup>681</sup> See Business Conduct Adopting Release, 81 FR at 30097.

<sup>682</sup> This was based on the estimate that each request would require approximately 80 hours of in-house counsel time, plus \$80,000 for the services of outside professionals (based on 200 hours of outside time × \$400/hour). See *id.*

<sup>683</sup> See Trade Acknowledgment and Verification Adopting Release, 81 FR at 39832.

professionals (incorporating an eight percent addition to reflect current dollars).

(g) Risk Management Control System Condition

The Commission estimated the burdens associated with compliance with the Rule 15c3–4 requirement to establish an internal risk management control system when it adopted those requirements for entities dually registered as a brokers or dealer and as a security-based swap dealer.<sup>684</sup> The Commission believes that those estimates are instructive for calculating the per-entity burdens associated with the creation of an internal risk management control system.

The Commission staff estimates that the requirement to comply with Rule 15c3–4 will result in one-time and annual hour burdens to the registered entity. The Commission staff estimates that the average amount of time an entity will spend implementing its risk management control system will be 2,000 hours, resulting in an industry-wide one-time hour burden of 48,000 hours across the 24 registered entities not already subject to Rule 15c3–4.<sup>685</sup> In implementing its policies and procedures, the registered entity is required to document and record its system of internal risk management controls. The Commission staff

estimates that each of these 24 registered entities will spend approximately 250 hours per year reviewing and updating their risk management control systems to comply with Rule 15c3–4, resulting in an industry-wide annual hour burden of approximately 6,000 hours.<sup>686</sup>

The registered entities engaged in arranging, negotiating, or executing activity in the United States may incur start-up costs to comply with the provisions of Rule 15c3–4, including information technology costs. The Commission estimates that a registered entity will incur an average of approximately \$16,000 for initial hardware and software expenses, while the average ongoing cost will be approximately \$20,500 per registered entity, for a total industry-wide initial cost of \$384,000 and an ongoing cost of \$492,000 per year.<sup>687</sup>

(h) Conditions Associated With the Use of Exception for Covered Inter-Dealer Security-Based Swaps

• *Filing Notice with the Commission.* The Commission estimates that the notice requirement associated with the use of the conditional exception for covered inter-dealer security-based swaps will result in annual hour burdens to registered entities. The Commission estimates each registered entity will file one notice with the

Commission. In addition, the Commission estimates that it will take a registered entity approximately 30 minutes to file this notice, resulting in an industry-wide annual hour burden of 12 hours.<sup>688</sup>

• *Creating, Obtaining, and Maintaining Threshold Compliance Documentation.* To comply with the condition that the affiliated registered entity obtain from the non-U.S. person, and maintain, copies of documentation regarding such non-U.S. person's compliance with the inter-dealer threshold, the registered entity and the non-U.S. person jointly would need to develop policies and procedures to provide for the creation of such records and for their transfer to and maintenance by the registered affiliate. For each use of the exception, the Commission estimates that such policies and procedures would impose a one-time initial burden of 20 hours.<sup>689</sup>

The Commission also estimates that the non-U.S. person relying on this exception also would need to expend two hours per week to create such records and to electronically convey the records to its registered affiliate.<sup>690</sup> The Commission further estimates that the registered affiliate would need to expend one hour per week in connection with the receipt and maintenance of those records.<sup>691</sup>

TABLE 6—RULE 3a71–3 AMENDMENT—SUMMARY OF PAPERWORK REDUCTION ACT BURDENS

Burden type	Initial burden		Annual burden	
	Per-firm	Aggregate	Per-firm	Aggregate
<i>Disclosure of limited Title VII applicability:</i> *				
disclosure by 12 U.S. dealing entities (A) .....			1,050.75 hr .....	12,609 hr.
disclosure by 2 non-U.S. dealing entities (B) .....			1,677.3 hr .....	3,355 hr.
disclosure by other non-U.S. entities (C) .....			35.2 hr .....	352 hr.
related policies and procedures .....	100 hr .....	2,400 hr.		
(same) .....	\$30,598 .....	\$734,352.		
<i>Disclosure of risks, characteristics et al:</i>				
structuring, legal, operations, compliance .....	1,200 hr .....	28,800 hr.		
re-evaluation and modification .....			120 hr .....	2,880 hr.
systems development, programming, testing .....	8,000 hr .....	192,000 hr.		
system maintenance .....			4,000 hr .....	96,000 hr.
<i>Suitability:</i>				
reps. by participants also in swap market .....	1 hr .....	1,116 hr.		
representations by other counterparties .....	2.5 hr .....	1,245 hr.		
<i>Fair and balanced communications:</i>				
statement drafting .....	\$6,487.2 .....	\$155,693.		
additional internal review .....	6 hr .....	144 hr.		
legal costs .....	\$9082 .....	\$217,970.		
<i>Trade acknowledgment and verification:</i>				
internal order and trade mgt. systems .....	355 hr .....	8,520 hr.		
daily tech. support/amortized upgrades .....			436 hr .....	10,464 hr.
initial preparation of policies and procedures .....	80 hr .....	1,920 hr.		
maintenance of policies and procedures .....			40 hr .....	960 hr.

<sup>684</sup> See Capital, Margin, and Segregation Adopting Release, 84 FR 43963.

<sup>685</sup> 24 registered entities × 2,000 hours = 48,000 hours.

<sup>686</sup> 24 registered entities × 250 hours = 6,000 hours.

<sup>687</sup> 24 registered entities × \$16,000 = \$384,000; 24 registered entities × \$20,500 = \$492,000.

<sup>688</sup> Across the 24 potential uses of the exception, this would amount to a total of 12 hours (24 entities × ½ hours). The estimate is based on a notice requirement associated with the alternative compliance mechanism outlined in Rule 18a–10. See Capital, Margin, and Segregation Adopting Release, 84 FR 43967.

<sup>689</sup> Across the 24 potential uses of the exception, this would amount to a total of 480 hours (24 entities × 20 hours).

<sup>690</sup> Across the 24 potential uses of the exception, this would amount to a total of 2,496 hours annually (24 entities × 2 hours × 52 weeks).

<sup>691</sup> Across the 24 potential uses of the exception, this would amount to a total of 1,248 hours annually (24 entities × 1 hour × 52 weeks).



TABLE 6—RULE 3a71–3 AMENDMENT—SUMMARY OF PAPERWORK REDUCTION ACT BURDENS—Continued

Burden type	Initial burden		Annual burden	
	Per-firm	Aggregate	Per-firm	Aggregate
<i>Copies of trading relationship documentation:</i>				
joint development of policies/procedures .....	20 hr .....	480 hr.		
non-US entity identification and conveyance .....			104 hr .....	2,496 hr.
registered entity receipt and maintenance .....			52 hr .....	1,248 hr.
<i>Consent to service of process:</i>				
joint drafting/transfer to registered entity .....	2 hr .....	48 hr.		
<i>“Listed jurisdiction” applications:</i>				
applications by non-regulators .....	80 hr .....	240 hr.		
(same) .....	\$86,496 .....	\$259,488.		
Notice of ANE activity filed with the Commission .....	½ hr .....	12 hr.		
<i>Compliance with inter-dealer threshold documentation:</i>				
joint development of policies/procedures .....	20 hr .....	480 hr.		
non-US entity creation and conveyance .....			104 hr .....	2,496 hr.
registered entity receipt and maintenance .....			52 hr .....	1,248 hr.
<i>Risk mgmt. control systems:</i>				
establishment of the systems .....	2,000 hr .....	48,000 hr.		
maintenance and review of the systems .....			250 hr .....	6,000 hr.
information technology costs .....	\$16,000 .....	\$384,000 .....	\$20,500 .....	\$492,000.

\* (A) Twelve U.S. dealing entities may book future security-based swaps with non-U.S. counterparties into non-U.S. affiliates. (B) Two non-U.S. entities may fall below the *de minimis* threshold if “arranged, negotiated, or executed” transactions are not counted. (C) Ten additional non-U.S. entities may make use of the exception to avoid incurring assessment costs in connection with the “arranged, negotiated, or executed” *de minimis* test.

## 5. Collection of Information Is

### Mandatory

The collections of information associated with the amendments to Rule 3a71–3 are mandatory to the availability of the exception.

### 6. Confidentiality

Any disclosures to be provided in connection with the arranging, negotiating, or executing activity of a registered entity in compliance with the requirements of the exception would be provided to the non-U.S. counterparties of the non-U.S. person relying on this exception; therefore, the Commission would not typically receive confidential information as a result of this collection of information. To the extent that the Commission receives records related to such disclosures from a registered entity through the Commission’s examination and oversight program, or through an investigation, or some other means, such information would be kept confidential, subject to the provisions of applicable law.

### 7. Retention Period of Recordkeeping Requirements

By virtue of being registered as a security-based swap dealer and/or as a broker, the entity engaged in market facing conduct in the United States will be required to retain the records and information required under the amendment to Rule 3a71–3 for the retention periods specified in Exchange Act Rules 17a–4 and 18a–6, as applicable.<sup>692</sup>

<sup>692</sup> The registered entity would have to create and/or maintain certain records in connection with the following conditions: Disclosure of limited Title VII applicability; business conduct; trade

## B. Amendments to Rule 18a–5

### 1. Summary of Collections of Information

The amendments to Rule 18a–5 relate to the requirements that stand-alone and bank SBS Entities make and keep current certain records.<sup>693</sup> These amendments to Rule 18a–5 reduce the burden associated with Rule 18a–5 by providing generally that a stand-alone or bank SBS Entity need not: (i) Make and keep current a questionnaire or application for employment for an associated person if the SBS Entity is excluded from the prohibition under Exchange Act Section 15F(b)(6) with respect to such associated person (e.g., the exclusion in Rule of Practice 194(c)(2)), and (ii) include the information described in paragraphs (a)(10)(i)(A) through (H) and (b)(8)(i)(A) through (H) of Rule 18a–5, unless the SBS Entity (1) is required to obtain such information under applicable law in the jurisdiction in which the associated person is employed or located or (2) obtains such information in conducting a background check that is customary for such firms in that jurisdiction, and the creation or maintenance of records reflecting that information would not result in a violation of applicable law in the jurisdiction in which the associated person is employed or located. The security-based swap dealer or major

acknowledgment and verification; obtaining and maintaining relationship documentation and questionnaires; and consent to service of process.

The conditions do not require the non-U.S. person relying on the exception to make or retain any particular types of records (although that non-U.S. person will be required to convey certain documentation to its registered affiliate).

<sup>693</sup> See 17 CFR 240.18a–5.

security-based swap participant still must comply with Section 15F(b)(6) of the Exchange Act.

### 2. Use of Information

Rule 18a–5, as amended, is designed, among other things, to promote the prudent operation of SBS Entities, and to assist the Commission, SROs, and state securities regulators in conducting effective examinations.<sup>694</sup> Thus, the collections of information under Rule 18a–5, as amended, are expected to facilitate inspections and examinations of SBS Entities.

### 3. Respondents

The Commission estimated the number of respondents in the Proposing Release. The Commission received no comment on these estimates. The Commission slightly modified its proposed estimates in the Recordkeeping and Reporting Adopting Release.<sup>695</sup> We continue to believe the modified estimates are appropriate.

Consistent with the Recordkeeping and Reporting Adopting Release, based on available data regarding the single-name CDS market—which the Commission believes will comprise the majority of security-based swaps—the Commission estimates that the number

<sup>694</sup> As noted above, Rule 18a–5 is patterned after Exchange Act Rule 17a–3, the recordkeeping rule for registered broker-dealers. See, e.g., Books and Records Requirements for Brokers and Dealers Under the Securities Exchange Act of 1934, Exchange Act Release No. 47910 (Oct. 26, 2001), 66 FR 55818 (Nov. 2, 2001) (“The Commission has required that broker-dealers create and maintain certain records so that, among other things, the Commission, [SROs], and State Securities Regulators . . . may conduct effective examinations of broker-dealers” (footnote omitted)).

<sup>695</sup> See Recordkeeping and Reporting Adopting Release, 84 FR at 68607–09.

of major security-based swap participants likely will be five or fewer and, in actuality, may be zero.<sup>696</sup> Therefore, to capture the likely number of major security-based swap participants that may be subject to the collections of information for purposes of this PRA, the Commission estimates for purposes of this PRA that five entities will register with the Commission as major security-based swap participants. Also consistent with the Recordkeeping and Reporting Adopting Release, the Commission estimates that approximately four major security-based swap participants will be stand-alone entities.<sup>697</sup>

Consistent with prior releases, the Commission estimates that 50 or fewer entities ultimately may be required to register with the Commission as security-based swap dealers, of which 16 are broker-dealers that will likely seek to register as security-based swap-dealers.<sup>698</sup> The Commission continues to estimate that approximately 75% of the 34 non-broker-dealer security-based swap dealers (*i.e.*, 25 firms) will register as bank security-based swap dealers, and the remaining 25% (*i.e.*, 9 firms) will register as stand-alone security-based swap dealers.<sup>699</sup>

Finally, as indicated in the Recordkeeping and Reporting Adopting Release, the Commission estimates that three stand-alone SBSDs will elect to operate under Rule 18a-10 which contains an alternative compliance mechanism that allows a stand-alone SBSD that is registered as a swap dealer and predominantly engages in a swaps business to elect to comply with the recordkeeping and reporting requirements of the CEA and the CFTC's rules in lieu of complying with Rule 18a-5 (among others).<sup>700</sup>

Further, the Commission continues to estimate that each security-based swap dealer will employ approximately 420 associated persons that are natural persons and each major security-based swap participant will employ

approximately 62 associated persons that are natural persons.<sup>701</sup> The Commission has no data regarding how many associated persons of SBS Entities who are non-U.S. natural persons may: (a) Not effect or be involved in effecting security-based swap transactions with or for counterparties that are U.S. persons (other than a security-based swap transaction conducted through a foreign branch of a counterparty that is a U.S. person); (b) effect or be involved in effecting security-based swap transactions with or for counterparties that are U.S. persons, but who may be employed or located in jurisdictions where the receipt of information required by the questionnaire or employment application, or the creation or maintenance of records reflecting that information, would result in a violation of applicable law; or (c) effect or be involved in effecting security-based swap transactions with or for counterparties that are U.S. persons, who are employed or located in jurisdictions where local law would not restrict the receipt, creation or maintenance of information required by the questionnaire or employment application. Given that, the Commission estimates, for purposes of this Paperwork Reduction Act analysis, that non-U.S. associated persons are evenly split into each of these categories.

#### 4. Total Initial and Annual Recordkeeping and Reporting Burden

As indicated in the Recordkeeping and Reporting Adopting Release, Rule 18a-5 will impose collection of information requirements that result in initial and annual burdens for SBS Entities. The amendments to Rule 18a-5 will decrease these burdens for certain SBS Entities.

Rule 18a-5 requires that stand-alone SBS Entities make and keep current 13 types of records, including records on associated persons.<sup>702</sup> The Commission estimated, in the Recordkeeping and Reporting Adopting Release, that those 13 paragraphs would impose an initial burden of 260 hours and an ongoing annual burden of 325 hours on each

stand-alone SBS Entity.<sup>703</sup> In addition, Rule 18a-5 would require that bank SBS Entities make and keep current 10 types of records, including records on associated persons.<sup>704</sup> The Commission estimated, in the Recordkeeping and Reporting Adopting Release, that these ten paragraphs will impose an initial burden of 200 hours and an ongoing burden of 250 hours on each bank SBS Entity.<sup>705</sup> The Commission further stated that while Rule 18a-5 will impose a burden to make and keep current these records, it would not require the firm to perform the underlying task.<sup>706</sup> The Commission continues to believe these estimated burdens are appropriate.

The amendments to paragraphs (a)(10) and (b)(8) of Rule 18a-5 (a) exempt stand-alone and bank SBS Entities from the requirement to make and keep current a questionnaire or application for employment for an associated person if the SBS Entity is excluded from the prohibition in section 15F(b)(6) of the Exchange Act with respect to the associated person (*e.g.*, the exclusion in Rule of Practice 194(c)(2)), and (b) allow SBS Entities to exclude information from their associated person records unless the SBS Entity (1) is required to obtain such information under applicable law in the jurisdiction in which the associated person is employed or located or (2) obtains such information in conducting a background check that is customary for such firms in that jurisdiction, and the creation or maintenance of records reflecting that information would not result in a

<sup>703</sup> See Recordkeeping and Reporting Adopting Release, 84 FR at 68610. Of these total initial and ongoing annual burdens for the 13 types of records a firm would be required to make and keep current under paragraph (a)(10) of Rule 18a-5, Commission staff believes that the burdens associated with making and keeping current questionnaires or applications for employment would be an initial burden of 20 hours (or 260/13) and an ongoing burden of 25 hours (or 325/13).

<sup>704</sup> 17 CFR 240.18a-5(b)(8).

<sup>705</sup> See Recordkeeping and Reporting Adopting Release, 84 FR at 68611. Of these total initial and ongoing annual burdens for the 10 types of records a firm would be required to make and keep current under paragraph (b)(8) of Rule 18a-5, Commission staff believes that the burdens associated with making and keeping current questionnaires or applications for employment would be an initial burden of 20 hours (or 200/10) and an ongoing burden of 25 hours (or 250/10).

<sup>706</sup> See Recordkeeping and Reporting Adopting Release, 84 FR at 68610. In estimating the burden associated with Rule 18a-5, the Commission recognizes that entities that will register stand-alone and bank SBS Entities likely already make and keep current some records as a matter of routine business practice, but the Commission does not have information about the records that such entities currently keep. Therefore, the Commission assumes, solely for purposes of estimating PRA burdens for these entities, that they currently keep no records.

<sup>696</sup> See Recordkeeping and Reporting Adopting Release, 84 FR at 68607; *see also* Capital, Margin, and Segregation Adopting Release 84 FR at 43960, and Registration Adopting Release, 80 FR at 48990.

<sup>697</sup> See Recordkeeping and Reporting Adopting Release, 84 FR at 68610.

<sup>698</sup> See Recordkeeping and Reporting Adopting Release, 84 FR at 68607; *see also* Capital, Margin, and Segregation Adopting Release 84 FR at 43959-60, and Registration Adopting Release, 80 FR at 48990.

<sup>699</sup> See Recordkeeping and Reporting Adopting Release, 84 FR at 68608; *see also see also* Capital, Margin, and Segregation Adopting Release 84 FR at 43959-60. The Commission does not anticipate that any firms will be dually registered as a broker-dealer and a bank.

<sup>700</sup> See Recordkeeping and Reporting Adopting Release, 84 FR at 68621.

<sup>701</sup> See Proposing Release, 84 at 24286; *see also* Rule of Practice 194 Adopting Release, 84 FR at 4926. Commission staff also checked with the staff at the National Futures Association regarding an approximate number of associated persons employed by registered swap dealers. NFA staff provided anecdotal information indicating that the number of natural persons that are associated persons of swap dealers is substantially similar to Commission staff estimates. NFA staff further indicated that they believe about half of the total number of natural persons that are associated persons of swap dealers are located in the U.S. and the other half are located in foreign jurisdictions.

<sup>702</sup> 17 CFR 240.18a-5(a)(10).

violation of applicable law in the jurisdiction in which the associated person is employed or located.

(a) Addition of Paragraphs (a)(10)(iii)(A) and (b)(8)(iii)(A)

The Commission estimates that the amendment to add paragraphs (a)(10)(iii)(A) and (b)(8)(iii)(A) to Rule 18a-5 would eliminate the paperwork burden for stand-alone and bank SBS Entities associated with making and keeping current questionnaires or applications for employment records, otherwise required by Rule 18a-5, with respect to any associated person if the SBS Entity is excluded from the prohibition in Exchange Act Section 15F(b)(6), including the exclusion in Rule of Practice 194(c)(2) with respect to a natural person who is (i) not a U.S. person and (ii) does not effect and is not involved in effecting security-based swap transactions with or for counterparties that are U.S. persons (other than a security-based swap transaction conducted through a foreign branch of a counterparty that is a U.S. person).

As indicated above, the Commission estimates that there will be approximately 4 stand-alone major security-based swap participants, 6 stand-alone security-based swap dealers and 25 bank security-based swap dealers. Further, as indicated above, we estimate that each security-based swap dealer will have approximately 420 associated persons and half of those associated persons, or 210, would not be employed or located in the U.S. The Commission estimates that stand-alone and bank SBS dealers would not need to obtain the questionnaire or application for employment for one third of those associated persons, or 70, because Rule of Practice 194(c)(2) provides an exclusion from the prohibition in Section 15F(b)(6) of the Exchange Act with respect to associated persons who are not located in the U.S. and do not effect and are not involved in effecting security-based swap transactions with or for counterparties that are U.S. persons (other than a security-based swap transaction conducted through a foreign branch of a counterparty that is a U.S. person).<sup>707</sup> Similarly, as indicated above, each major security-based swap participant

would have approximately 62 associated persons and half of those associated persons, or 31, would not be employed or located in the U.S. The Commission estimates that stand-alone major security-based swap participants would not need to obtain the questionnaire or application for employment for one third of those associated persons, or 10, because Rule of Practice 194(c)(2) provides an exclusion from the prohibition in Section 15F(b)(6) of the Exchange Act with respect to those associated persons.<sup>708</sup>

Given this, the addition of paragraphs (a)(10)(iii)(A) and (b)(8)(iii)(A) to Rule 18a-5 will reduce the initial burden associated with Rule 18a-5 by 117 hours<sup>709</sup> and it will reduce the ongoing burden associated with Rule 18a-5 by 145 hours.<sup>710</sup>

<sup>708</sup> 10 associated persons/62 associated persons per major security-based swap participant = a reduction of approximately 16.1%. Major security-based swap participants would be able to utilize this paragraph relative to other exclusions from the requirements of Exchange Act Section 15F(b)(6) that the Commission may provide, however the analysis is focusing solely on the exclusion provided by the addition of paragraph (c)(2) to Rule of Practice 194 for purposes of this Paperwork Reduction Act estimate.

<sup>709</sup> Initial burden hours associated with paragraphs (a)(10) and (b)(8) of Rule 18a-5 for stand-alone and bank security-based swap dealers and major security-based swap participants—

20 hours × (6 stand-alone security-based swap dealers + 25 bank security-based swap dealers) = 20 hours × 31 security-based swap dealers = 620 initial burden hours for security-based swap dealers.

20 hours × 4 stand-alone major security-based swap participants = 80 initial burden hours for major security-based swap participants.

*Initial burden hour reduction:*

620 initial burden hours for security-based swap dealers × 16.7% (see n.707, *supra*) = 104 hours. 80 initial burden hours for major security-based swap participants × 16.1% (see n.708, *supra*) = 13 hours. A 104 hour reduction in the initial burden for security-based swap dealers + a 13 hour reduction in the initial burden for major security-based swap participants = a 117 hour reduction in initial burden hours across all entities able to rely on Rule 18a-5(a)(10) and (b)(8).

<sup>710</sup> Ongoing burden hours associated with paragraph (a)(10) and (b)(8) of Rule 18a-5 for stand-alone and bank security-based swap dealers and major security-based swap participants—

25 hours × (6 stand-alone security-based swap dealers + 25 bank security-based swap dealers) = 25 hours × 31 security-based swap dealers = 775 ongoing burden hours for security-based swap dealers.

25 hours × 4 stand-alone major security-based swap participants = 100 ongoing burden hours for major security-based swap participants.

*Ongoing burden hour reduction:*

775 ongoing burden hours for security-based swap dealers × 16.7% (see n.707, *supra*) = 129 hours. 100 ongoing burden hours for major security-based swap participants × 16.1% (see n.708, *supra*) = 16 hours. A 129 hour reduction in the ongoing burden for security-based swap dealers + a 16 hour reduction in the ongoing burden for major security-based swap participants = a 145 hour reduction in ongoing burden hours across all entities able to rely on Rule 18a-5(a)(10) and (b)(8).

(b) Addition of Paragraphs (a)(10)(iii)(B) and (b)(8)(iii)(B)

The Commission estimates that the amendment to add paragraphs (a)(10)(iii)(B) and (b)(8)(iii)(B) to Rule 18a-5 will decrease the paperwork burden for stand-alone and bank SBS Entities by permitting the exclusion of information mandated by the questionnaire requirement with respect to associated natural persons who effect or are involved in effecting security-based swap transactions with U.S. counterparties, unless the SBS Entity (1) is required to obtain such information under applicable law in the jurisdiction in which the associated person is employed or located or (2) obtains such information in conducting a background check that is customary for such firms in that jurisdiction, and the creation or maintenance of records reflecting that information would not result in a violation of applicable law in the jurisdiction in which the associated person is employed or located.

As indicated above, the Commission estimates that there will be approximately 4 stand-alone major security-based swap participants, 6 stand-alone security-based swap dealers and 25 bank security-based swap dealers. Further, as indicated above, each security-based swap dealer would have approximately 420 associated persons and half of those associated persons, or 210, would not be employed or located in the U.S. The Commission estimates that these new paragraphs will permit stand-alone and bank security-based swap dealers to exclude certain information mandated by the questionnaire requirement for approximately one third of those associated persons, or 70.<sup>711</sup> Similarly, as indicated above, each major security-based swap participant would have approximately 62 associated persons and half of those associated persons, or 31, would not be employed or located in the U.S. The Commission estimates that these new paragraphs will permit stand-alone major security-based swap participants to exclude certain information mandated by the questionnaire requirement for approximately one third of those associated persons, or 10.<sup>712</sup>

The Commission estimates that this will reduce the burdens associated with obtaining the information specified in the questionnaire requirement by 50% for the affected associated persons. Given this, the addition of paragraphs (a)(10)(iii)(B) and (b)(8)(iii)(B) to Rule

<sup>707</sup> 70 associated persons/420 associated persons per security-based swap dealer = a reduction of approximately 16.7%. Security-based swap dealers would be able to utilize this paragraph relative to other exclusions from the requirements of Exchange Act Section 15F(b)(6) that the Commission may provide, however the analysis is focusing solely on the exclusion provided by the addition of paragraph (c)(2) to Rule of Practice 194 for purposes of the Paperwork Reduction Act estimate.

<sup>711</sup> See text accompanying note 707, *supra*.

<sup>712</sup> See text accompanying note 708, *supra*.

18a–5 will reduce the initial burden associated with Rule 18a–5 by 58 hours<sup>713</sup> and will reduce the ongoing burden associated with Rule 18a–5 by 73 hours.<sup>714</sup>

Thus, in total, the addition of both paragraphs (a)(10)(iii)(A) and (b)(8)(iii)(A) and paragraphs (a)(10)(iii)(B) and (b)(8)(iii)(B) will reduce the initial burden associated with the questionnaire requirement in Rule 18a–5 by 175 hours,<sup>715</sup> and the ongoing burden associated with the questionnaire requirement in Rule 18a–5 by 218 hours.<sup>716</sup>

<sup>713</sup> Initial burden hours associated with paragraphs (a)(10) and (b)(8) of Rule 18a–5 for stand-alone and bank security-based swap dealers and major security-based swap participants—

20 hours × (6 stand-alone security-based swap dealers + 25 bank security-based swap dealers) = 20 hours × 31 security-based swap dealers = 620 initial burden hours for security-based swap dealers.

20 hours × 4 stand-alone major security-based swap participants = 80 initial burden hours for major security-based swap participants.

Initial burden hour reduction:

(620 initial burden hours for security-based swap dealers × 16.7% (see n.707, *supra*) × 50%) = 52 hours. (80 initial burden hours for major security-based swap participants × 16.1% (see n.708, *supra*) × 50%) = 6 hours. A 52 hour reduction in the initial burden for security-based swap dealers + a 6 hour reduction in the initial burden for major security-based swap participants = a 58 hour reduction in initial burden hours across all entities able to rely on Rule 18a–5(a)(10) and (b)(8).

<sup>714</sup> Ongoing burden hours associated with paragraph (a)(10) and (b)(8) of Rule 18a–5 for stand-alone and bank security-based swap dealers and major security-based swap participants—

25 hours × (6 stand-alone security-based swap dealers + 25 bank security-based swap dealers) = 20 hours × 34 security-based swap dealers = 775 ongoing burden hours for security-based swap dealers.

25 hours × 4 stand-alone major security-based swap participants = 100 ongoing burden hours for major security-based swap participants.

Ongoing burden hour reduction:

(775 ongoing burden hours for security-based swap dealers × 16.7% (see n.707 *supra*) × 50%) = 65 hours. (100 ongoing burden hours for major security-based swap participants × 16.1% (see n.708 *supra*) × 50%) = 8 hours. A 65 hour reduction in the ongoing burden for security-based swap dealers + a 8 hour reduction in the ongoing burden for major security-based swap participants = a 73 hour reduction in ongoing burden hours across all entities able to rely on Rule 18a–5(a)(10) and (b)(8).

<sup>715</sup> A 127 hour reduction in initial burden hours associated with the addition of paragraphs (a)(10)(iii)(A) and (b)(8)(iii)(A) and a 63 hour reduction in initial burden hours associated with the addition of paragraphs (a)(10)(iii)(B) and (b)(8)(iii)(B) = a 190 hour reduction in initial burden hours.

<sup>716</sup> A 158 hour reduction in ongoing burden hours associated with the addition of paragraphs (a)(10)(iii)(A) and (b)(8)(iii)(A) and a 79 hour reduction in ongoing burden hours associated with the addition of paragraphs (a)(10)(iii)(B) and (b)(8)(iii)(B) = a 237 hour reduction in ongoing burden hours.

## 5. Collection of Information Is Mandatory

The collections of information pursuant to Rule 18a–5, as amended, are mandatory for SBS Entities.

## 6. Confidentiality

Information that an SBS Entity is required to make and keep current under Rule 18a–5 will be maintained by the firm. To the extent that the Commission collects such records during an inspection or examination of a registered SBS Entity, or through some other means, such records would generally be kept confidential, subject to the provisions of applicable law.<sup>717</sup>

## 7. Retention Period for Recordkeeping Requirements

Rule 18a–6 establishes the required retention periods for SBS Entities to maintain records collected in accorded with Rule 18a–5.<sup>718</sup> Under paragraph (d)(1) of Rule 18a–6, an SBS Entity is required to maintain and preserve in an easily accessible place the records required under paragraphs (a)(10) and (b)(8) of Rule 18a–5 until at least three years after the associated person's employment and any other connection with the SBS Entity has terminated.

## VIII. Other Matters

If any of the provisions of these rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

Pursuant to the Congressional Review Act,<sup>719</sup> the Office of Information and Regulatory Affairs has designated these rules as a major rule, as defined by 5 U.S.C. 804(2).

## IX. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act of 1980 (“RFA”) <sup>720</sup> requires the Commission to consider the impact of the rules on “small entities,” <sup>721</sup> a term that includes “small businesses,” “small organizations,” and “small governmental jurisdictions.” <sup>722</sup> In the Proposing Release, the Commission certified, pursuant to Section 605(b) of

the RFA,<sup>723</sup> that the proposed amendments to Exchange Act Rules 3a71–3, 15Fb2–1, 0–13, 18a–5 and Rule of Practice 194 would not have a significant economic impact on a substantial number of small entities.<sup>724</sup> The Commission received no comments on this certification.

For purposes of Commission rulemaking in connection with the RFA,<sup>725</sup> a small business or small organization includes: (1) When used with reference to an “issuer” or a “person,” other than an investment company, an “issuer” or “person” that, on the last day of its most recent fiscal year, had total assets of \$5 million or less;<sup>726</sup> or (2) a broker-dealer with total capital (net worth plus subordinated liabilities) of less than \$500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a–5(d) under the Exchange Act,<sup>727</sup> or, if not required to file such statements, a broker-dealer with total capital (net worth plus subordinated liabilities) of less than \$500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization.<sup>728</sup> The Commission has not adopted a definition for the term “small governmental jurisdiction,” so the RFA’s default definition of the term applies; accordingly, the term includes “governments of cities, counties, towns, townships, villages, school districts, or special districts, with a population of less than fifty thousand.” <sup>729</sup> The Small Business Administration defines small businesses in the finance and insurance industry to include the following: (i) For depository credit intermediation and credit card issuing, business concerns with \$600 million or less in assets;<sup>730</sup> (ii) for non-depository credit

<sup>723</sup> 5 U.S.C. 605(b).

<sup>724</sup> See Proposing Release, 84 FR at 24290.

<sup>725</sup> Although the RFA, 5 U.S.C. 601(3)–(6), defines the term “small entity,” the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the terms “small business” and “small organization” for the purposes of Commission rulemaking in accordance with the RFA. Those definitions, as relevant to this proposed rulemaking, are set forth in Rule 0–10 under the Exchange Act, 17 CFR 240.0–10. See Exchange Act Release No. 18451 (Jan. 28, 1982), 47 FR 5215 (Feb. 4, 1982) (File No. AS–305).

<sup>726</sup> See 17 CFR 240.0–10(a).

<sup>727</sup> See 17 CFR 240.17a–5(d).

<sup>728</sup> See 17 CFR 240.0–10(c).

<sup>729</sup> 5 U.S.C. 601(5).

<sup>730</sup> See 13 CFR 121.201 (Subsector 522). A financial institution’s assets are determined by averaging the assets reported on its four quarterly financial statements for the preceding year. See *id.* at n.8.

<sup>717</sup> See, e.g., 5 U.S.C. 552 *et seq.*; 15 U.S.C. 78x (governing the public availability of information obtained by the Commission).

<sup>718</sup> See 17 CFR 240.18a–6(d)(1).

<sup>719</sup> 5 U.S.C. 801 *et seq.*

<sup>720</sup> 5 U.S.C. 601–612.

<sup>721</sup> 5 U.S.C. 605(b).

<sup>722</sup> 5 U.S.C. 601(3)–(6).

intermediation and certain other activities related to credit intermediation, business concerns with annual receipts not exceeding a threshold between \$8 million and \$41.5 million depending on the type of business;<sup>731</sup> (iii) for financial investments and related activities, business concerns with \$41.5 million or less in annual receipts;<sup>732</sup> (iv) for insurance carriers and related activities, business concerns with annual receipts not exceeding a threshold between \$8 million and \$41.5 million depending on the type of business;<sup>733</sup> and (v) for funds, trusts, and other financial vehicles, business concerns with \$35 million or less in annual receipts.<sup>734</sup>

For purposes of the exception to Exchange Act Rule 3a71–3, the Commission continues to believe, based on feedback from market participants and information about the security-based swap markets, that the types of entities that would engage in more than a *de minimis* amount of dealing activity involving security-based swaps are part of large financial institutions that exceed the thresholds defining “small entities” as set forth above. Accordingly, the Commission expects that all of the firms that are likely to make use of the exception to Rule 3a71–3 would not be “small entities” for purposes of the RFA.<sup>735</sup> The exception to Exchange Act Rule 3a71–3 is subject to conditions requiring arranging, negotiating, or executing activity to be conducted by registered security-based swap dealers or by registered brokers, in each case that are affiliated with the non-U.S. persons relying on the exception. It is possible that some non-U.S. persons may set up new security-based swap dealers or new brokers to make use of the exception, while other non-U.S. persons that seek to make use of the exception instead may make use of an existing affiliated registered security-based swap dealer or existing affiliated

registered broker.<sup>736</sup> By definition, any such affiliated existing or new broker would not be a “small entity.”<sup>737</sup> Moreover, even in the unlikely event that some non-U.S. persons were to satisfy the exception’s conditions via the use of affiliated registered security-based swap dealers that fall within the definition of “small entity” for purposes of the RFA,<sup>738</sup> the Commission continues to believe that there would not be a substantial number of such entities.<sup>739</sup>

Based on feedback from industry participants about the security-based swap markets, the Commission continues to believe that entities that will qualify as SBS Entities exceed the thresholds defining “small entities.” Thus, the Commission believes that any SBS Entities that may seek to rely on the proposed amendment to Rule 15Fb2–1 would not be “small entities” for purposes of the RFA.<sup>740</sup>

The Commission also continues to believe that any SBS Entities—*i.e.*, registered security-based swap dealers and registered major security-based swap participants—with associated persons that may be the subject of the proposed amendments to Rule of Practice 194 would not be “small entities” for purposes of the RFA.<sup>741</sup>

<sup>736</sup> See Part VI.A.7, *supra* (discussing likely broker or security-based swap dealer affiliates of persons expected to rely on the exception).

<sup>737</sup> The “small entity” definition applied to brokers excludes brokers that are affiliated with a person that is not a “small entity.” See Exchange Act Rule 0–10(c)(2), (i)(1), 17 CFR 240.0–10(c)(2), (i)(1) (basing affiliation on an 25 percent ownership standard that is narrower than the majority ownership standard used in connection with this conditional exception). Because the non-U.S. persons relying on this exception would not be “small entities,” see note 735, *supra*, and accompanying text, any such affiliated broker also would not be a “small entity.”

<sup>738</sup> As noted above, the Commission continues to believe, based on feedback from market participants and information about the security-based swap markets, that the types of entities that would engage in more than a *de minimis* amount of dealing activity involving security-based swaps are part of large financial institutions that do not qualify as “small entities.” If the affiliated registered security-based swap dealer itself engages in security-based swap dealing activity above the *de minimis* thresholds, then the Commission accordingly believes that this affiliated registered security-based swap dealer would not be a “small entity.”

<sup>739</sup> Similarly, the Commission believes that there would not be a significant number of “small entities” that may file “listed jurisdiction” applications pursuant to the proposed amendments to Exchange Act Rule 0–13. This conclusion reflects the same reasons, as well as the expectation that the majority of such applications would be filed by foreign authorities that do not qualify as “small entities.”

<sup>740</sup> See Registration Adopting Release, 80 FR at 49013.

<sup>741</sup> We previously have concluded, based on feedback from market participants and the Commission’s information regarding the security-

The Commission further continues to believe that it is unlikely that the requirements applicable to SBS Entities that would be established under the amendments to Rule 18a–5 would have a significant economic impact on any small entity because no SBS Entity will be a small entity.<sup>742</sup>

Accordingly, the Commission believes that it is unlikely that the rule amendments would have a significant economic impact on a substantial number of small entities.<sup>743</sup>

For the foregoing reasons, the Commission certifies that the amendments to Exchange Act Rules 3a71–3, 15Fb2–1, 0–13, and 18a–5, and Rule of Practice 194 would not have a significant economic impact on a substantial number of small entities for purposes of the RFA.

## X. Effective Date and Compliance Dates

### A. Effective Date

These final rules will be effective on the later of March 1, 2020, or 60 days following publication of this release in the **Federal Register** (the “Effective Date”). The Commission is setting the Effective Date not to occur before March 1, 2020, to provide certainty for market participants regarding the timing of both the Effective Date and the compliance dates discussed below.

### B. Compliance Dates

As explained in the Recordkeeping and Reporting Adopting Release, the compliance date for registration of SBS Entities (the “Registration Compliance Date”) will be 18 months after the Effective Date set forth above in Part X.A. As the Commission noted in its adopting releases for rules regarding SBS Entity registration<sup>744</sup> and treatment of non-U.S. persons’ security-based swap dealing transactions that are arranged, negotiated, or executed by U.S. personnel,<sup>745</sup> “for purposes of

based swap market, that the types of entities that may have security-based swap positions above the level required to register as SBS Entities would not be “small entities” for purposes of the RFA. See Cross-Border Adopting Release, 79 FR at 47368; see also Applications by Security-based Swap Dealers or Major Security-Based Participants for Statutorily Disqualified Associated Persons to Effect or Be Involved in Effecting Security-Based Swaps, Exchange Act Release No. 75612 (Aug. 5, 2015), 80 FR 51684, 51718 (Aug. 25, 2015) and Rule of Practice 194 Adopting Release, 84 FR at 4944.

<sup>742</sup> See Recordkeeping and Reporting Adopting Release, 84 FR at 68645.

<sup>743</sup> See also Parts VI (Economic Analysis) and VII (Paperwork Reduction Act) (discussing, among other things, the economic impact of the rules, including estimated compliance costs and burdens).

<sup>744</sup> See Registration Adopting Release, 80 FR at 48988.

<sup>745</sup> See ANE Adopting Release, 81 FR at 8637.

<sup>731</sup> See *id.* at Subsector 522.

<sup>732</sup> See *id.* at Subsector 523.

<sup>733</sup> See *id.* at Subsector 524.

<sup>734</sup> See *id.* at Subsector 525. In the Proposing Release, the Commission erroneously reported outdated thresholds in the Small Business Administration’s definition of small businesses engaged in the finance and insurance industry. See Proposing Release, 84 FR at 24289. This error did not impact the Commission’s certification that the proposed rules would not have a significant impact on a substantial number of small entities.

<sup>735</sup> See also ANE Adopting Release, 81 FR at 8636; Application of Certain Title VII Requirements to Security-Based Swap Transactions Connected With a Non-U.S. Person’s Dealing Activity That A 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, Exchange Act Release No. 74834 (April 29, 2015), 80 FR 27443, 27503 (May 13, 2015) (“ANE Proposing Release”); Cross-Border Adopting Release, 79 FR at 47368.

complying with the [SBS Entity] registration and other requirements, persons are not required to begin calculating whether their activities meet or exceed [registration thresholds] until two months prior to the Registration Compliance Date.”<sup>746</sup> Accordingly, the compliance date for the amendments to Exchange Act Rule 3a71–3 will be two months prior to the Registration Compliance Date. The compliance date for the amendments to Exchange Act Rules 18a–5 and 15Fb2–1 will be the same as the Registration Compliance Date. Finally, the compliance date for the amendments to Exchange Act Rule 0–13 and Rule of Practice 194 will be the same as the Effective Date.

In addition, the Commission has coordinated the compliance dates for several additional rules relevant to SBS Entities with the Registration Compliance Date: (1) SBS Entity segregation requirements and nonbank SBS Entity capital and margin requirements;<sup>747</sup> (2) SBS Entity recordkeeping and reporting requirements;<sup>748</sup> (3) SBS Entity business conduct standards;<sup>749</sup> and (4) SBS Entity trade acknowledgment and verification requirements.<sup>750</sup> Compliance with each of these rules will be required beginning on the Registration Compliance Date.

One commenter stated that, if the Commission determines to retain requirements that a non-U.S. person count against security-based swap dealer registration thresholds its dealing transactions with a non-U.S. counterparty that were arranged, negotiated, or executed by U.S. personnel, potential registrants would need an *additional* 18 months beyond 18 months after the Effective Date to come into compliance.<sup>751</sup> Two commenters stated that the Commission should delay the Registration Compliance Date for SBS Entities until 18 months after the Commission issues substituted compliance decisions for all relevant jurisdictions.<sup>752</sup> By contrast, two other commenters urged the Commission to implement Title VII without further delay.<sup>753</sup>

The Commission believes that the Registration Compliance date previously adopted in the Capital, Margin, and Segregation Adopting Release will allow sufficient time to prepare for and come in to compliance with the requirements for SBS Entities noted above, including the requirements for counting of transactions that are arranged, negotiated, or executed by U.S. personnel.<sup>754</sup> The Commission adopted in February 2016 its final rules regarding counting of security-based swap transactions that are arranged, negotiated, or executed by U.S. personnel, and has not proposed to eliminate these requirements. The Commission does not believe it is necessary to further delay the Registration Compliance Date until the Commission has acted on any substituted compliance applications. The Commission considered the need for action with respect to applications for substituted compliance when it set the extended Registration Compliance Date<sup>755</sup> and continues to believe that 18 months after the Effective Date should afford the Commission and potential registrants with sufficient time. As noted above in Part III.H.2, the Commission welcomes requests for substituted compliance ahead of the Registration Compliance Date and encourages potential applicants to begin the process of requesting substituted compliance as soon as practicable.<sup>756</sup>

### C. Compliance With Rules for Security-Based Swap Data Repositories and Regulation SBSR

The issuance of this release has certain implications for the compliance schedule for Regulation SBSR, which governs regulatory reporting and public dissemination of security-based swap (“SBS”) transactions.<sup>757</sup> Under

Regulation SBSR, the first compliance date (“Compliance Date 1”) for affected persons with respect to an SBS asset class is the first Monday that is the later of: (1) Six months after the date on which the first SBS data repository (“SDR”) that can accept transaction reports in that asset class registers with the Commission; or (2) one month after the Registration Compliance Date.<sup>758</sup> As explained in the Recordkeeping and Reporting Adopting Release, the Registration Compliance Date will be 18 months after the Effective Date set forth above in Part X.A of this release. Although the second condition precedent of Regulation SBSR compliance has now been determined, the first condition precedent remains undetermined, as no SDR has registered with the Commission.

In issuing this release and in light of the completion of many other Title VII rulemakings as well as the changing regulatory landscape since the Commission’s consideration of Regulation SBSR and the SDR rules, the Commission has considered how all of the Title VII rules will work on full implementation and, in particular, the role of SDRs. The Commission recognizes that the CFTC rules analogous to the SBS reporting rules have been in force for several years<sup>759</sup>

81 FR 53546. Regulation SBSR and the SDR rules are hereinafter referred to collectively as the “SBS reporting rules.”

<sup>758</sup> See Regulation SBSR Amendments Adopting Release, 81 FR at 53603. There could be different compliance dates for different asset classes, depending on whether the first SDR that registers with the Commission can accept transaction reports in all SBS asset classes or only certain asset classes.

<sup>759</sup> In 2011, the CFTC adopted its Part 49 rules that establish registration standards, duties, and core principles for swap data repositories. See 17 CFR part 49: Swap Data Repositories: Registration Standards, Duties and Core Principles, 76 FR 54538 (Sept. 1, 2011) (adopting release). In 2012, the CFTC adopted its Part 43 rules, 17 CFR part 43, that provide for real-time public dissemination of swap transactions. See Real-Time Public Reporting of Swap Transaction Data, 77 FR 1182 (Jan. 9, 2012) (adopting release). Also in 2012, the CFTC adopted its Part 45 rules, 17 CFR part 45, that provide for regulatory reporting of swap transactions. See Swap Data Recordkeeping and Reporting Requirements, 77 FR 2136 (Jan. 13, 2012) (adopting release). The Part 45 rules were subsequently amended to provide for regulatory reporting of pre-enactment and transition swaps, see Amendments to Swap Data Recordkeeping and Reporting Requirements, 77 FR 35200 (Jun. 12, 2012) (adopting release), and to establish recordkeeping and reporting requirements for cleared swaps, see Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transitions Swaps, 81 FR 41736 (Jun. 27, 2016) (adopting release). The Part 43 rules were subsequently amended to provide for the public dissemination of block transactions. See Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades, 78 FR 32866 (May 31, 2013) (adopting release). The Part 43, Part 45, and Part 49 rules, as amended, are hereinafter referred to collectively as the “swap reporting rules.”

<sup>746</sup> Registration Adopting Release, 80 FR at 48988; see also ANE Adopting Release, 81 FR at 8637.

<sup>747</sup> See Capital, Margin, and Segregation Adopting Release, 84 FR at 43954.

<sup>748</sup> See Recordkeeping and Reporting Adopting Release, 84 FR at 68600–01.

<sup>749</sup> See Business Conduct Adopting Release, 81 FR at 30081–82.

<sup>750</sup> See Trade Acknowledgment and Verification Adopting Release, 81 FR at 39828–29.

<sup>751</sup> See ISDA letter at 5.

<sup>752</sup> See IIB/SIFMA letter at 31–32; Credit Suisse/UBS letter at 3.

<sup>753</sup> See Better Markets letter at 4; Citadel letter at 6.

and multiple entities have registered with the CFTC as swap data repositories.<sup>760</sup> Most of the participants in the SBS market are also participants in the swap market, including the two entities that previously sought registration with the Commission as SDRs.<sup>761</sup> The Commission understands that these market participants and swap data repositories have invested in systems and developed policies and procedures to comply with the CFTC's swap reporting rules. Although Regulation SBSR's Compliance Date 1 has not yet been determined, certain persons subject to both the swap and SBS reporting rules have identified operational inefficiencies that could arise from differences between these rules. For example, two commenters have argued that differences among the data fields, reporting mechanics, and cross-border application of the swap and SBS reporting rules limit the ability of affected entities to use common systems across the two rulesets.<sup>762</sup>

The Commission also is cognizant that the CFTC has announced a review of the swap reporting rules with a "focus on changes to the existing regulations and guidance with two goals in mind: (a) To ensure that the CFTC receives accurate, complete, and high quality data on swaps transactions for its regulatory oversight role; and (b) to streamline reporting, reduce messages that must be reported, and right-size the number of data elements that are reported to meet the agency's priority use-cases for swaps data."<sup>763</sup> As part of that effort, the CFTC earlier in 2019 proposed amendments to its rules for swap data repositories<sup>764</sup> and indicated that this was the first of three anticipated rulemakings to revise the swap reporting rules.<sup>765</sup>

The Commission is mindful of the time and costs that may be incurred by swap data repositories and swap market participants to implement aspects of the SBS reporting rules that have no analog

in, or are not wholly consistent with, the swap reporting rules. Implementation of SEC-specific requirements could require changes to the systems, policies, and procedures currently utilized to comply with the swap reporting rules. These burdens could be exacerbated if affected parties must begin complying with the SBS reporting rules at or near the same time that they are making changes to their systems, policies, and procedures to accommodate amendments made by the CFTC to the swap reporting rules.

The Commission believes that implementation of the SBS reporting rules can and should be done in a manner that carries out the fundamental policy goals of the SBS reporting rules while minimizing burdens as much as practicable. The Commission continues to believe that this should be done pursuant to the compliance schedule noted above.<sup>766</sup> However, in light of the Commission's efforts to promote harmonization, the CFTC's announced reconsideration of its swap reporting rules, and ongoing concerns among market participants about incurring unnecessary burdens, the Commission takes the following position with respect to the SBS reporting rules for four years following Regulation SBSR's Compliance Date 1 in each SBS asset class. After the first SDR that can accept transaction reports in a particular SBS class is registered by the Commission, certain actions with respect to the SBS reporting rules will not provide a basis for a Commission enforcement action, as set forth below:<sup>767</sup>

1. With respect to Rule 901(a) of Regulation SBSR if a person with a duty to report an SBS transaction (or a duty to participate in the selection of the reporting side) under Rule 901(a) does not report the transaction (or does not participate in the selection of the reporting side) because, under the swap reporting rules in force at the time of the transaction, a different person (or no person) would have the duty to report a comparable swap transaction.

2. With respect to Rules 901(c)(2)–(7) and 901(d) of Regulation SBSR, if a person with a duty to report a data element of an SBS transaction, as required by any provision of Rules 901(c)(2)–(7) and 901(d), does not report that data element because the swap reporting rules in force at the time of the transaction do not require that data element to be reported.

<sup>766</sup> See note 719, *supra*.

<sup>767</sup> Unless specified otherwise, all terms shall have the definitions set forth in Section 3(a) of the Exchange Act, 15 U.S.C. 78c, and the rules and regulations thereunder, including Regulation SBSR.

3. With respect to Rule 901(e) of Regulation SBSR, if a person does not report a life cycle event of an SBS transaction in a manner consistent with Rule 901(e) and the person acts instead in a manner consistent with the swap reporting rules for the reporting of life cycle events that are in force at the time of the life cycle event.

4. With respect to Rule 902 of Regulation SBSR, if a registered SDR does not disseminate an SBS transaction in a manner consistent with Rule 902 but instead disseminates (or does not disseminate) the SBS transaction in a manner consistent with Part 43 of the CFTC's swap reporting rules in force at the time of the transaction, provided that for an SBS based on a single credit instrument or a narrow-based index of credit instruments having a notional size of \$5 million or greater, the registered SDR that receives the report of the SBS transaction does not utilize any capping or bucketing convention under Part 43 of the CFTC's swap reporting rules but instead disseminates a capped size of \$5 million (*e.g.*, "\$5MM+" or similar) in lieu of the true notional size.<sup>768</sup>

5. With respect to Rule 903(b), a registered SDR permits the reporting or public dissemination of SBS transaction information that includes codes in place of certain data elements even if the information necessary to interpret such codes is not widely available to users of the information on a non-fee basis.<sup>769</sup>

6. With respect to Rule 906(a) of Regulation SBSR, if a registered SDR does not send reports of missing unique identification codes to its participants.

7. With respect to Rule 906(b) of Regulation SBSR, if a registered SDR does not collect ultimate parent and affiliate information from its participants.

8. With respect to Rule 907(a)(1) of Regulation SBSR, if a registered SDR does not enumerate in its policies and procedures for reporting transaction information one or more specific data elements that are required by Rule 901(c) or 901(d) of Regulation SBSR,

<sup>768</sup> The Commission notes that the Financial Industry Regulatory Authority applies a \$5 million cap when disseminating transaction reports of economically similar cash debt securities. *See, e.g.*, FINRA Regulatory Notice 12–39, available at <https://www.finra.org/rules-guidance/notices/12-39>.

<sup>769</sup> An international initiative has been developing a system for the assignment of unique product identifiers ("UPIs") for products involved in over-the-counter derivatives transactions. The UPIs that would be assigned by a UPI Service Provider are anticipated to serve as product IDs under Regulation SBSR. As this initiative continues to develop, the Commission anticipates that it will inform market participants of the availability of UPIs and address any related issues raised under Rule 903(b) of Regulation SBSR.

<sup>760</sup> See <https://sirt.cftc.gov/sirt/sirt.aspx?Topic=DataRepositories>.

<sup>761</sup> See Exchange Act Release No. 77699 (April 22, 2016), 81 FR 25475 (April 28, 2016) (notice of filing of SDR application of ICE Trade Vault); Exchange Act Release No. 78216 (June 30, 2016), 81 FR 44379 (July 7, 2016) (notice of filing of SDR application of DDR).

<sup>762</sup> See Memorandum prepared by Institute of International Bankers and Securities Industry and Financial Markets Associated (June 21, 2018), available at: <https://www.sec.gov/comments/s7-05-14/s70514-3938974-167037.pdf>.

<sup>763</sup> CFTC Letter 17–33 (July 10, 2017), available at <https://www.cftc.gov/sites/default/files/idc/groups/public/lrlettergeneral/documents/letter/17-33.pdf>.

<sup>764</sup> See Certain Swap Data Repository and Data Reporting Requirements, 84 FR 21044 (May 13, 2019) (proposing release).

<sup>765</sup> See *id.* at 21045–46.



because such data element(s) are not required under the swap reporting rules, except that the registered SDR's policies and procedures must set out how a participant must identify the SBS and any security underlying the SBS and thereby comply with Rule 901(c)(1).

9. With respect to Rule 907(a)(3) of Regulation SBSR, if a registered SDR does not enumerate in its policies and procedures for handling life cycle events provisions that are not required under swap reporting rules that pertain to the reporting of life cycle events.

10. With respect to Rule 907(a)(4) of Regulation SBSR, if a registered SDR does not have policies and procedures for establishing and directing its participants to use condition flags in the reporting of SBS transactions, provided that the registered SDR instead complies with analogous CFTC rules regarding condition flags or other trade indicators.

11. With respect to Rule 907(a)(5) of Regulation SBSR, if a registered SDR does not have policies and procedures for assigning UICs.

12. With respect to Rule 907(a)(6) of Regulation SBSR, if a registered SDR does not have policies and procedures for obtaining from its participants information about each participant's ultimate parent and affiliates.

Notwithstanding the above, the Commission's position with respect to Rule 901(a) of Regulation SBSR does not extend to instances where a transaction falls within Rule 901(a)(2)(ii)(E) and one or both sides is relying on the exception to the *de minimis* counting requirement for ANE transactions (*i.e.*, is a "relying entity"). The Commission expects that a foreign dealing entity that is a relying entity would utilize staff of an affiliated U.S. registered SBS dealer or broker-dealer to report an ANE transaction.<sup>770</sup>

<sup>770</sup> The Commission notes that Rule 906(c) of Regulation SBSR, in relevant part, requires each participant of a registered SDR that is a registered SBS dealer or a registered broker-dealer that incurs reporting duties to establish, maintain, and enforce written policies and procedures that are reasonably designed to ensure that it complies with any obligation to report information to a registered SDR in the manner consistent with Regulation SBSR. In light of the rule amendments adopted today regarding ANE transactions, the Commission expects a registered SBS dealer or registered broker-dealer that arranges, negotiates, or executes SBS transactions on behalf of a foreign affiliate that is a relying entity to include in its Rule 906(c) policies and procedures a mechanism for noting, with respect to a specific security-based swap transaction, the foreign affiliate on whose behalf it is arranging, negotiating, or executing the transaction; for ensuring that any such transaction is reported to a registered SDR (or, as applicable, ensuring that it engages with the other side to select which side will incur the reporting duty); and for ensuring that inter-dealer ANE transactions where it is acting on behalf of the reporting side are publicly disseminated. The Commission may review the Rule 906(c) policies and procedures of

Furthermore, the Commission's position with respect to Rule 902(a) of Regulation SBSR does not extend to: (1) A covered inter-dealer security-based swap transaction that at least one side of the transaction arranges, negotiates, or executes in reliance on the exception in Rule 3a71-3(d); or (2) a security based swap transaction between a relying entity and a registered SBS dealer (whether or not it is a U.S. person). All other aspects of the Commission's position extend to the transactions described in this paragraph.

Similarly, the Commission takes the position that, for a period of four years following Regulation SBSR's Compliance Date 1 in a particular SBS asset class, certain actions with respect to the SDR rules will not provide a basis for a Commission enforcement action against a registered SDR that can accept transaction reports in that asset class, as set forth below.

1. With respect to Section 13(n)(5)(B) of the Exchange Act<sup>771</sup> and Rule 13n-4(b)(3) thereunder,<sup>772</sup> if a registered SDR does not confirm with both counterparties to the SBS the accuracy of the data that was submitted to the SDR.

2. With respect to Rule 13n-5(b)(1)(iii) under the Exchange Act, if a registered SDR does not establish, maintain, and enforce written policies and procedures reasonably designed to satisfy itself that the transaction data that has been submitted to the SDR is complete and accurate, and clearly identifies the source for each trade side and the pairing method (if any) for each transaction in order to identify the level of quality of the transaction data that was submitted to the SDR.

3. A registered SDR does not adhere to any provision of Section 11A(b) of the Exchange Act<sup>773</sup> pertaining to securities information processors.

The Commission will assess an application to register as an SDR and make applicable findings pursuant to Rule 13n-1(c) under the Exchange Act<sup>774</sup> in light of this position. Thus, an

registered SBS dealers and registered broker-dealers to evaluate whether the Commission's position is being applied as set forth in this statement.

<sup>771</sup> 15 U.S.C. 78m(n)(5)(B).

<sup>772</sup> 17 CFR 240.13n-4(b)(3).

<sup>773</sup> 15 U.S.C. 78k-1.

<sup>774</sup> 17 CFR 240.13n-1(c) ("The Commission shall grant the registration of a security-based swap data repository if the Commission finds that such security-based swap data repository is so organized, and has the capacity, to be able to assure the prompt, accurate, and reliable performance of its functions as a security-based swap data repository, comply with any applicable provision of the federal securities laws and rules and regulations thereunder, and carry out its functions in a manner consistent with the purposes of section 13(n) of the

applicant will not need to include materials in its application explaining how it would comply with the provisions noted above, and could instead rely on its discussion about how it complies with comparable CFTC requirements. Specifically, an entity wishing to register with the Commission as an SDR must still submit an application on Form SDR. However, the entity need not provide an Exhibit S to describe its functions as a securities information processor and may instead represent in its application that it: (1) Is registered with the CFTC as an swap data repository; (2) is in compliance with applicable requirements under the swap reporting rules; (3) satisfies the standard for Commission registration of an SDR under Rule 13n-1(c); and (4) intends to rely on this position for the period set forth in this release with respect to any SBS asset class(es) for which it intends to accept transaction reports. Furthermore, an entity submitting an application to register would not need to comply with the requirement in Rule 13n-1(b) and Rule 13n-11(f)(5) to file Form SDR and all amendments "electronically in a tagged data format" but instead would be able to submit such documents to the Commission electronically as portable document format (PDF) files, consistent with the CFTC SDR application procedures under Part 49.3(a)(1).<sup>775</sup>

The Commission believes that the approach outlined above would result in useful transaction data being made available to the Commission, other relevant authorities, and the public while the Commission assesses whether and, if so, how to take further steps toward harmonization and the CFTC undertakes its review of swap reporting rules.<sup>776</sup>

[Exchange] Act and the rules and regulations thereunder.").

<sup>775</sup> Accordingly, compliance with General Instructions I on Form SDR or the applicable provisions of Regulation S-T also would not be required.

<sup>776</sup> This relief is consistent with the Commission's efforts to harmonize other of its Title VII requirements with the CFTC's. For example, in the Capital, Margin, and Segregation Adopting Release, the Commission adopted new Rule 18a-10 under the Exchange Act, 17 CFR 240.18a-10, which permits an SBS dealer that is also registered with the CFTC as a swap dealer to comply with the capital, margin, and segregation requirements of the CEA and the CFTC's rules—rather than comparable SEC rules—provided that the firm's SBS business is not a significant part of the SBS market and predominantly involves dealing in swaps as compared to SBS. *See* Capital, Margin, and Segregation Adopting Release, 84 FR at 43943-44. The Commission stated that Rule 18a-10 was designed to "address the concern raised by the commenters that it would be inefficient to impose differing requirements on a firm that is predominantly a swap dealer." *Id.* at 43944. Also, in the Recordkeeping and Reporting Adopting

The Commission's position applies only to the exercise of its enforcement discretion and is expressly limited to the Commission's SBS reporting rules discussed above. Nothing in this position excuses compliance with the other SBS reporting rules or any other Commission rule, including a rule that implements one or more other provisions of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. This position will remain in effect until the earlier of (1) four years following Regulation SBSR's Compliance Date 1 in a particular SBS asset class, or (2) 12 months after the Commission provides notice that the position will expire.

#### *D. Effect on Existing Commission Exemptive Relief*

Compliance with certain provisions of the Exchange Act and certain rules and regulations thereunder in connection with security-based swap transactions, positions, and/or activity is currently subject to temporary exemptive relief granted by the Commission.<sup>777</sup> As set forth in the Commission's prior releases, certain portions of this temporary exemptive relief will expire on the Registration Compliance Date,<sup>778</sup> while

Release, the Commission added the recordkeeping and reporting requirements to that alternative compliance mechanism and crafted a "limited alternative compliance mechanism" that allow an SBS dealer or major SBS participant to comply with the recordkeeping requirements of the CEA and the rules thereunder applicable to swap dealers and major swap participants in lieu of complying with the requirements in Rules 17a-3 and 18a-5 under the Exchange Act, 17 CFR 240.17a-3 and 240.18a-5, to make and keep current trade blotters, customer account ledgers, and stock records solely with respect to information required to be included in these records regarding SBS transactions and positions, subject to certain conditions. *See* Recordkeeping and Reporting Adopting Release, 84 FR at 68593-94.

<sup>777</sup> *See, e.g.*, Temporary Exemptions and Other Temporary Relief, Together With Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps, Exchange Act Release No. 64678 (June 15, 2011), 76 FR 36287 (June 22, 2011); Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revisions of the Definition of "Security" to Encompass Security-Based Swaps, Exchange Act Release No. 64795 (July 1, 2011), 76 FR 39927 (July 7, 2011); Order Granting Conditional Exemptions Under the Securities Exchange Act of 1934 in Connection With Portfolio Margining of Swaps and Security-Based Swaps, Exchange Act Release No. 68433 (Dec. 14, 2012), 77 FR 75211 (Dec. 19, 2012) ("Portfolio Margining Order").

<sup>778</sup> *See, e.g.*, Order Pursuant to Sections 15F(b)(6) and 36 of the Securities Exchange Act of 1934 Extending Certain Temporary Exemptions and an Temporary and Limited Exception Related to Security-Based Swaps, Exchange Act Release No. 75919 (Sept. 15, 2015), 80 FR 56519, 56522 (Sept. 18, 2015); Registration Adopting Release, 80 FR at 49003; Business Conduct Adopting Release, 81 FR at 29967-68; Trade Acknowledgment and Verification Adopting Release, 81 FR at 39825

certain other portions of this relief are subject to conditions that will be triggered upon the Registration Compliance Date.<sup>779</sup> Other portions of this temporary relief are scheduled to expire on February 5, 2020.<sup>780</sup> Similarly, the Commission's 2018 statement of position regarding certain actions with respect to provisions of the Commission's business conduct rules for SBS Entities contains a sunset provision that will begin to run starting on the Registration Compliance Date.<sup>781</sup>

#### **XI. Statutory Basis and Text of the Rule Amendments**

Pursuant to the Exchange Act, 15 U.S.C. 78a *et seq.*, and particularly Sections 3(a)(71), 3(b), 15F (as added by Section 764(a) of the Dodd-Frank Act), 17(a), 23(a) and 30(c) thereof, and Section 761(b) of the Dodd-Frank Act, the Commission is amending Rule of Practice 194 and Rules 0-13, 3a71-3, 15Fb2-1 and 18a-5 under the Exchange Act. Additionally, the Commission is adopting Rule 3a71-3(d)(4) under the Exchange Act pursuant to Exchange Act Sections 15(a) and 36 and Rule 3a71-3(d)(5) under the Exchange Act pursuant to Exchange Act Section 36.

#### **List of Subjects**

##### *17 CFR Part 201*

Administrative practice and procedure, Brokers, Claims, Confidential business information, Equal access to justice, Lawyers, Penalties, Securities.

##### *17 CFR Part 240*

Brokers, Confidential business information, Fraud, Reporting and recordkeeping requirements, Securities.

#### **Text of Final Rules**

For the reasons stated in the preamble, the Commission is amending

n.189; Capital, Margin, and Segregation Adopting Release, 84 FR at 43955-57; Recordkeeping and Reporting Adopting Release, 84 FR at 68001-02.

<sup>779</sup> *See* Portfolio Margining Order, 77 FR 75211; Capital, Margin, and Segregation Adopting Release, 84 FR at 43956-57.

<sup>780</sup> *See* Order Granting a Limited Exemption From the Exchange Act Definition of "Penny Stock" for Security-Based Swap Transactions Between Eligible Contract Participants; Granting a Limited Exemption From the Exchange Act Definition of "Municipal Securities" for Security-Based Swaps; and Extending Certain Temporary Exemptions Under the Exchange Act in Connection With the Revision of the Definition of "Security" to Encompass Security-Based Swaps, Exchange Act Release No. 84991, (Jan. 25, 2019), 84 FR 863 (Jan. 31, 2019).

<sup>781</sup> *See* Commission Statement on Certain Provisions of Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 84511 (Oct. 31, 2018), 83 FR 55486 (Nov. 6, 2018).

Title 17, Chapter II of the Code of the Federal Regulations as follows:

#### **PART 201—RULES OF PRACTICE**

■ 1. The authority citation for subpart D is revised to read as follows:

**Authority:** 15 U.S.C. 77f, 77g, 77h, 77h-1, 77j, 77s, 77u, 77sss, 77ttt, 78(c)(b), 78d-1, 78d-2, 78l, 78m, 78n, 78o(d), 78o-3, 78o-10(b)(6), 78s, 78u-2, 78u-3, 78v, 78w, 80a-8, 80a-9, 80a-37, 80a-38, 80a-39, 80a-40, 80a-41, 80a-44, 80b-3, 80b-9, 80b-11, 80b-12, 7202, 7215, and 7217.

■ 2. Amend § 201.194 by redesignating paragraph (c) as paragraph (c)(1), adding paragraph (c) subject heading, and adding paragraph (c)(2) to read as follows:

**§ 201.194 Applications by security-based swap dealers or major security-based swap participants for statutorily disqualified associated persons to effect or be involved in effecting security-based swaps.**

\* \* \* \* \*

##### *(c) Exclusions.*

\* \* \* \* \*

(2) *Exclusion for certain associated natural persons.* A security-based swap dealer or major security-based swap participant shall be excluded from the prohibition in section 15F(b)(6) of the Exchange Act (15 U.S.C. 78o-10(b)(6)) with respect to an associated person who is a natural person who (i) is not a U.S. person (as defined in 17 CFR 240.3a71-3(a)(4)(i)(A)) and (ii) does not effect and is not involved in effecting security-based swap transactions with or for counterparties that are U.S. persons (as defined in 17 CFR 240.3a71-3(a)(4)), other than a security-based swap transaction conducted through a foreign branch (as that term is defined in 17 CFR 240.3a71-3(a)(3)) of a counterparty that is a U.S. person; *provided, however*, that this exclusion shall not be available if the associated person of that security-based swap dealer or major security-based swap participant is currently subject to any order described in subparagraphs (A) and (B) of section 3(a)(39) of the Exchange Act, with the limitation that an order by a foreign financial regulatory authority described in subparagraphs (B)(i) and (B)(iii) of section 3(a)(39) (15 U.S.C. 78c(a)(39)(B)(i) and (B)(iii)) shall only apply to orders by a foreign financial regulatory authority in the jurisdiction where the associated person is employed or located.

\* \* \* \* \*

## PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

■ 3. The general authority citation for part 240 continues to read as follows:

**Authority:** 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c–3, 78c–5, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78l, 78m, 78n, 78n–1, 78o, 78o–4, 78o–10, 78p, 78q, 78q–1, 78s, 78u–5, 78w, 78x, 78ll, 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, 7201 *et seq.*; and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; and Pub. L. 111–203, 939A, 124 Stat. 1887 (2010); and secs. 503 and 602, Pub. L. 112–106, 126 Stat. 326 (2012), unless otherwise noted.

\* \* \* \* \*

■ 4. Amend § 240.0–13 by revising the section heading and paragraphs (a), (b), and (e) to read as follows:

### § 240.0–13 Commission procedures for filing applications to request a substituted compliance or listed jurisdiction order under the Exchange Act.

(a) The application shall be in writing in the form of a letter, must include any supporting documents necessary to make the application complete, and otherwise must comply with § 240.0–3. All applications must be submitted to the Office of the Secretary of the Commission, by a party that potentially would comply with requirements under the Exchange Act pursuant to a substituted compliance or listed jurisdiction order, or by the relevant foreign financial regulatory authority or authorities. If an application is incomplete, the Commission may request that the application be withdrawn unless the applicant can justify, based on all the facts and circumstances, why supporting materials have not been submitted and undertakes to submit the omitted materials promptly.

(b) An applicant may submit a request electronically. The electronic mailbox to use for these applications is described on the Commission's website at [www.sec.gov](http://www.sec.gov) in the "Exchange Act Substituted Compliance and Listed Jurisdiction Applications" section. In the event electronic mailboxes are revised in the future, applicants can find the appropriate mailbox by accessing the "Electronic Mailboxes at the Commission" section.

\* \* \* \* \*

(e) Every application (electronic or paper) must contain the name, address, telephone number, and email address of each applicant and the name, address, telephone number, and email address of a person to whom any questions regarding the application should be

directed. The Commission will not consider hypothetical or anonymous requests for a substituted compliance or listed jurisdiction order. Each applicant shall provide the Commission with any supporting documentation it believes necessary for the Commission to make such determination, including information regarding applicable requirements established by the foreign financial regulatory authority or authorities, as well as the methods used by the foreign financial regulatory authority or authorities to monitor and enforce compliance with such rules. Applicants should also cite to and discuss applicable precedent.

\* \* \* \* \*

■ 5. Amend § 240.3a71–3 by adding paragraphs (a)(10) through (13), revising paragraph (b)(1)(iii)(C), and adding paragraph (d) to read as follows:

### § 240.3a71–3 Cross-border security-based swap dealing activity.

(a) \* \* \*

(10) An entity is a *majority-owned affiliate* of another entity if the entity directly or indirectly owns a majority interest in the other, or if a third party directly or indirectly owns a majority interest in both entities, where "majority interest" is the right to vote or direct the vote of a majority of a class of voting securities of an entity, the power to sell or direct the sale of a majority of a class of voting securities of an entity, or the right to receive upon dissolution, or the contribution of, a majority of the capital of a partnership.

(11) *Foreign associated person* means a natural person domiciled outside the United States who—with respect to a non-U.S. person relying on the exception set forth in paragraph (d) of this section—is a partner, officer, director, or branch manager of such non-U.S. person (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such non-U.S. person, or any employee of such non-U.S. person.

(12) *Listed jurisdiction* means any jurisdiction that the Commission by order has designated as a listed jurisdiction for purposes of the exception specified in paragraph (d) of this section.

(13) *Covered inter-dealer security-based swap* means any security-based swap between:

(i) A non-U.S. person relying on the exception in paragraph (d) of this section; and

(ii) A non-U.S. person that is, or is an affiliate of, a registered security-based swap dealer or registered broker that has

filed with the Commission a notice pursuant to paragraph (d)(1)(vi) of this section; *provided, however*, that a covered inter-dealer security-based swap does not include a security-based swap with a non-U.S. person that the non-U.S. person relying on the exception in paragraph (d) of this section reasonably determines at the time of execution of the security-based swap is neither a registered security-based swap dealer or registered broker that has filed with the Commission a notice pursuant to paragraph (d)(1)(vi) of this section nor an affiliate of such a registered security-based swap dealer or registered broker.

(b) \* \* \*

(1) \* \* \*

(iii) \* \* \*

(C) Except as provided in paragraph (d) of this section, or unless such person is a person described in paragraph (a)(4)(iii) of this section, security-based swap transactions connected with such person's security-based swap dealing activity that are arranged, negotiated, or executed by personnel of such non-U.S. person located in a U.S. branch or office, or by personnel of an agent of such non-U.S. person located in a U.S. branch or office; and

\* \* \* \* \*

(d) *Exception from counting certain transactions.* The counting requirement described by paragraph (b)(1)(iii)(C) of this section will not apply to the security-based swap dealing transactions of a non-U.S. person if the conditions of paragraph (d)(1) of this section have been satisfied.

(1) *Conditions*—(i) *Entity conducting U.S. activity.* All activity that otherwise would cause a security-based swap transaction to be described by paragraph (b)(1)(iii)(C) of this section—namely, all arranging, negotiating or executing activity that is conducted by personnel of the entity (or its agent) located in a branch or office in the United States—is conducted by such U.S. personnel in their capacity as persons associated with an entity that:

(A) Is registered with the Commission as:

(1) A broker registered under section 15 of the Act (15 U.S.C. 78o) that is subject to and complies with § 240.15c3–1(a)(7);

(2) A broker registered under section 15 of the Act (15 U.S.C. 78o), other than a broker that is subject to § 240.15c3–1(a)(7), that complies with § 240.15c3–1(a)(10), as if that entity were registered with the Commission as a security-based swap dealer, if it is not so registered; or

(3) A security-based swap dealer; and

(B) Is a majority-owned affiliate of the non-U.S. person relying on this exception.

(ii) *Compliance with specified security-based swap dealer requirements*—(A) *Compliance required.* In connection with such transactions, the registered entity described in paragraph (d)(1)(i) of this section complies with the requirements described in paragraph (d)(1)(ii)(B) of this section.

(1) As if the counterparties to the non-U.S. person relying on this exception also were counterparties to that entity; and

(2) As if that entity were registered with the Commission as a security-based swap dealer, if it is not so registered.

(B) *Applicable requirements.* The compliance obligation described in paragraph (d)(1)(ii)(A) of this section applies to the following provisions of the Act and the rules and regulations thereunder:

(1) Section 15F(h)(3)(B)(i), (ii) and § 240.15Fh-3(b), including in connection with material incentives and conflicts of interest associated with the non-U.S. person relying on the exception;

(2) Section 240.15Fh-3(f)(1); *provided, however*, that if the registered entity described in paragraph (d)(1)(i) of this section reasonably determines that the counterparty to whom it recommends a security-based swap or trading strategy involving a security-based swap is an “institutional counterparty” as defined in § 240.15Fh-3(f)(4), the registered entity instead may fulfill its obligations under § 240.15Fh-3(f)(1)(ii) if it discloses to the counterparty that it is not undertaking to assess the suitability of the security-based swap or trading strategy involving a security-based swap for the counterparty;

(3) Section 15F(h)(3)(C) of the Act and § 240.15Fh-3(g); and

(4) Sections 240.15Fi-1 and 240.15Fi-2.

(iii) *Commission access to books, records and testimony.* (A) The non-U.S. person relying on this exception promptly provides representatives of the Commission (upon request of the Commission or its representatives or pursuant to a supervisory or enforcement memorandum of understanding or other arrangement or agreement reached between any foreign securities authority, including any foreign government, as specified in section 3(a)(50) of the Act, and the Commission or the U.S. Government) with any information or documents within the non-U.S. person’s

possession, custody, or control, promptly makes its foreign associated persons available for testimony, and provides any assistance in taking the evidence of other persons, wherever located, that the Commission or its representatives requests and that relates to transactions subject to this exception; *provided, however*, that if, after exercising its best efforts, the non-U.S. person is prohibited by applicable foreign law or regulations from providing such information, documents, testimony, or assistance, the non-U.S. person may continue to rely on this exception until the Commission issues an order modifying or withdrawing an associated “listed jurisdiction” determination pursuant to paragraph (d)(2)(iii) of this section.

(B) The registered entity described in paragraph (d)(1)(i) of this section:

(1) Creates and maintains books and records relating to the transactions subject to this exception that are required, as applicable, by §§ 240.17a-3 and 240.17a-4, or by §§ 240.18a-5 and 240.18a-6, including any books and records requirements relating to the provisions specified in paragraph (d)(1)(ii)(B) of this section;

(2) Obtains from the non-U.S. person relying on the exception, and maintains for not less than three years following the activity described in paragraph (d)(1)(i) of this section, the first two years in an easily accessible place, documentation regarding such non-U.S. person’s compliance with the condition in paragraph (d)(1)(vii) of this section;

(3) Obtains from the non-U.S. person relying on the exception, and maintains for not less than three years following the activity described in paragraph (d)(1)(i) of this section, the first two years in an easily accessible place, documentation encompassing all terms governing the trading relationship between the non-U.S. person and its counterparty relating to the transactions subject to this exception, including, without limitation, terms addressing payment obligations, netting of payments, events of default or other termination events, calculation and netting of obligations upon termination, transfer of rights and obligations, allocation of any applicable regulatory reporting obligations, governing law, valuation, and dispute resolution; and

(4) Obtains from the non-U.S. person relying on this exception, and maintains for not less than three years following the activity described in paragraph (d)(1)(i) of this section, the first two years in an easily accessible place, written consent to service of process for any civil action brought by or proceeding before the Commission,

providing that process may be served on the non-U.S. person by service on the registered entity in the manner set forth in the registered entity’s current Form BD, SBSE, SBSE-A or SBSE-BD, as applicable.

(iv) *Counterparty notification.* In connection with the transaction, the registered entity described in paragraph (d)(1)(i) of this section notifies the counterparties of the non-U.S. person relying on this exception that the non-U.S. person is not registered with the Commission as a security-based swap dealer, and that certain Exchange Act provisions or rules addressing the regulation of security-based swaps would not be applicable in connection with the transaction, including provisions affording clearing rights to counterparties. Such notice shall be provided contemporaneously with, and in the same manner as, the arranging, negotiating, or executing activity at issue; *provided, however*, that during a period in which a counterparty is neither a customer (as such term is defined in § 240.15c3-3) of the registered entity described in paragraph (d)(1)(i) of this section (if such registered entity is a registered broker or dealer) nor a counterparty to a security-based swap with the registered entity described in paragraph (d)(1)(i) of this section, such notice need only be provided contemporaneously with, and in the same manner as, the first such arranging, negotiating, or executing activity during such period. This disclosure will not be required if the identity of that counterparty is not known to that registered entity at a reasonably sufficient time prior to the execution of the transaction to permit such disclosure.

(v) *Subject to regulation of a listed jurisdiction.* The non-U.S. person relying on this exception is subject to the margin and capital requirements of a listed jurisdiction when engaging in the transactions subject to this exception.

(vi) *Notice by registered entity.* Before an associated person of the registered entity described in paragraph (d)(1)(i) of this section commences the activity described in paragraph (d)(1)(i) of this section, such registered entity shall file with the Commission a notice that its associated persons may conduct such activity. Such registered entity shall file this notice by submitting it to the electronic mailbox described on the Commission’s website at [www.sec.gov](http://www.sec.gov) at the “ANE Exception Notices” section. The Commission shall publicly post such notice on the same section of its website.

(vii) *Limitation for covered inter-dealer security-based swaps.* The aggregate gross notional amount of covered inter-dealer security-based swap positions connected with dealing activity subject to the exception in this paragraph (d) engaged in by persons described in paragraph (d)(6)(i) of this section over the course of the immediately preceding 12 months does not exceed \$50 billion.

(2) *Order for listed jurisdiction designation.* The Commission by order, may conditionally or unconditionally determine that a foreign jurisdiction is a listed jurisdiction for purposes of this section. The Commission may make listed jurisdiction determinations in response to applications, or upon the Commission's own initiative.

(i) *Applications.* Applications for an order requesting listed jurisdiction status may be made by a party or group of parties that potentially would seek to rely on the exception provided by paragraph (d) of this section, or by any foreign financial regulatory authority or authorities supervising such a party or its security-based swap activities. Applications must be filed pursuant to the procedures set forth in § 240.0–13.

(ii) *Criteria considered.* In considering a foreign jurisdiction's potential status as a listed jurisdiction, the Commission may consider factors relevant for purposes of assessing whether such an order would be in the public interest, including:

(A) Applicable margin and capital requirements of the foreign financial regulatory system; and

(B) The effectiveness of the supervisory compliance program administered by, and the enforcement authority exercised by, the foreign financial regulatory authority in connection with such requirements, including the application of those requirements in connection with an entity's cross-border business.

(iii) *Withdrawal or modification of listed jurisdiction status.* The Commission may, on its own initiative, by order after notice and opportunity for comment, modify or withdraw a jurisdiction's status as a listed jurisdiction, if the Commission determines that continued listed jurisdiction status no longer would be in the public interest, based on:

(A) The criteria set forth in paragraph (d)(2)(ii) of this section;

(B) Any laws or regulations that have had the effect of preventing the Commission or its representatives, on request, to promptly access information or documents regarding the activities of persons relying on the exception provided by this paragraph (d), to obtain

the testimony of their foreign associated persons, and to obtain the assistance of persons relying on this exception in taking the evidence of other persons, wherever located, as described in paragraph (d)(1)(iii)(A) of this section; and

(C) Any other factor the Commission determines to be relevant to whether continued status as a listed jurisdiction would be in the public interest.

(3) *Exception for person that engages in arranging, negotiating, or executing activity as agent.* The registered entity described in paragraph (d)(1)(i) of this section need not count, against the *de minimis* thresholds described in § 240.3a71–2(a)(1), the transactions described by paragraph (d) of this section.

(4) *Limited exemption from registration as a broker.* A registered security-based swap dealer and its associated persons who conduct the activities described in paragraph (d)(1)(i) of this section shall not be subject to registration as a broker pursuant to section 15(a)(1) of the Act solely because the registered entity or the associated person conducts any activity described in paragraph (d)(1)(i) of this section with or for a person that is an eligible contract participant, *provided that*:

(i) The conditions of paragraph (d)(1) of this section are satisfied in connection with such activities; and

(ii) If § 240.10b–10 would apply to an activity subject to the exception in paragraph (d)(1)(i), such registered security-based swap dealer provides to the customer the disclosures required by § 240.10b–10(a)(2) (excluding § 240.10b–10(a)(2)(i) and (ii)) and § 240.10b–10(a)(8) in accordance with the time and form requirements set forth in § 240.15Fi–2(b) and (c) or, alternatively, promptly after discovery of any defect in the registered security-based swap dealer's good faith effort to comply with such requirements.

(5) *Exemption from § 240.10b–10.* A broker or dealer that is also a registered security-based swap dealer or registered broker described in paragraph (d)(1)(i) of this section shall be exempt from the requirements of § 240.10b–10 with respect to activity described in paragraph (d)(1)(i) of this section, *provided that* such broker or dealer:

(i) Complies with paragraph (d)(1)(ii)(B)(4) of this section in connection with such activity; and

(ii) Provides to the customer the disclosures required by § 240.10b–10(a)(2) (excluding § 240.10b–10(a)(2)(i) and (ii)) and § 240.10b–10(a)(8) in accordance with the time and form requirements set forth in § 240.15Fi–2(b)

and (c) or, alternatively, promptly after discovery of any defect in the broker or dealer's good faith effort to comply with such requirements.

(6) *Limitation for covered inter-dealer security-based swaps—(i) Scope of limitation for covered inter-dealer security-based swaps.* The threshold described in paragraph (d)(1)(vii) of this section applies to covered inter-dealer security-based swap positions connected with dealing activity subject to the exception in this paragraph (d) engaged in by any of the following persons:

(A) The non-U.S. person relying on the exception in this paragraph (d); and

(B) Any affiliate of such person, except for an affiliate that is deemed not to be a security-based swap dealer pursuant to Rule 3a71–2(b).

(ii) *Impact of exceeding exception threshold.* If the threshold described in paragraph (d)(1)(vii) of this section is exceeded, then

(A) As of the date the condition in paragraph (d)(1)(vii) of this section is no longer satisfied, the non-U.S. person that is no longer able to satisfy that condition may not rely on the exception in this paragraph (d) for future security-based swap transactions.

(B) For purposes of calculating the amount of security-based swap positions connected with dealing activity under § 240.3a71–2(a)(1), the non-U.S. person that is no longer able to satisfy the condition in paragraph (d)(1)(vii) of this section shall include all covered inter-dealer security-based swap positions connected with dealing activity subject to the exception in this paragraph (d) engaged in by persons described in paragraph (d)(6)(i) of this section over the course of the immediately preceding 12 months, such positions to be included in such calculation as of the date that the condition in paragraph (d)(1)(vii) of this section is no longer satisfied.

\* \* \* \* \*

■ 6. Section 240.15Fb2–1 is amended by revising paragraphs (d) and (e) to read as follows:

**§ 240.15Fb2–1 Registration of security-based swap dealers and major security-based swap participants**

\* \* \* \* \*

(d) *Conditional registration.* (1) An applicant that has submitted a complete Form SBSE–C (§ 249.1600c of this chapter) and a complete Form SBSE (§ 249.1600 of this chapter) or Form SBSE–A (§ 249.1600a of this chapter) or Form SBSE–BD (§ 249.1600b of this chapter), as applicable, in accordance with paragraph (c) within the time periods set forth in § 240.3a67–8 (if the

person is a major security-based swap participant) or § 240.3a71-2(b) (if the person is a security-based swap dealer), and has not withdrawn its registration shall be conditionally registered.

(2) Notwithstanding paragraph (d)(1) of this section, an applicant that is a nonresident security-based swap dealer or nonresident major security-based swap participant (each as defined in § 240.15Fb2-4(a)) that is unable to provide the certification and opinion of counsel required by § 240.15Fb2-4(c)(1) shall instead provide a conditional certification and opinion of counsel as discussed in paragraph (d)(3) of this section, and upon the provision of such conditional certification and opinion of counsel, shall be conditionally registered, if the nonresident applicant submits a Form SBSE-C (§ 249.1600c of this chapter) and a Form SBSE (§ 249.1600 of this chapter), SBSE-A (§ 249.1600a of this chapter) or SBSE-BD (§ 249.1600b of this chapter), as applicable, in accordance with paragraph (c) of this section within the time periods set forth in § 240.3a67-8 (if the person is a major security-based swap participant) or § 240.3a71-2(b) (if the person is a security-based swap dealer), that is complete in all respects but for the failure to provide the certification and the opinion of counsel required by § 240.15Fb2-4(c)(1), and has not withdrawn from registration.

(3) For purposes of this section, a conditional certification and opinion of counsel means a certification as required by § 240.15Fb2-4(c)(1)(i) and an opinion of counsel as required by § 240.15Fb2-4(c)(1)(ii) that identify, and are conditioned upon, the occurrence of a future action that would provide the Commission with adequate assurances of prompt access to the books and records of the nonresident security-based swap dealer or nonresident major security-based swap participant, and the ability of the nonresident security-based swap dealer or nonresident major security-based swap participant to submit to onsite inspection and examination by the Commission. Such future action could include:

(i) Entry by the Commission and the foreign financial regulatory authority of the jurisdiction(s) in which the nonresident security-based swap dealer or nonresident major security-based swap participant maintains the books and records that are addressed by the certification and opinion of counsel required by § 240.15Fb2-4(c)(1) into a memorandum of understanding, agreement, protocol, or other regulatory arrangement providing the Commission with adequate assurances of:

(A) Prompt access to the books and records of the nonresident security-based swap dealer or nonresident major security-based swap participant; and

(B) The ability of the nonresident security-based swap dealer or nonresident major security-based swap participant to submit to onsite inspection or examination by the Commission; or

(ii) Issuance by the Commission of an order granting substituted compliance in accordance with § 240.3a71-6 to the jurisdiction(s) in which the nonresident security-based swap dealer or nonresident major security-based swap participant maintains the books and records that are addressed by the certification and opinion of counsel required by § 240.15Fb2-4(c)(1); or

(iii) Any other action that would provide the Commission with the assurances required by § 240.15Fb2-4(c)(1)(i) and by § 240.15Fb2-4(c)(1)(ii).

(e) *Commission Decision.* (1) The Commission may deny or grant ongoing registration to a security-based swap dealer or major security-based swap participant based on a security-based swap dealer's or major security-based swap participant's application, filed pursuant to paragraph (a) of this section. The Commission will grant ongoing registration if it finds that the requirements of section 15F(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b)) are satisfied. The Commission may institute proceedings to determine whether ongoing registration should be denied if it does not or cannot make such finding or if the applicant is subject to a statutory disqualification (as described in sections 3(a)(39)(A) through (F) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(39)(A)-(F))), or the Commission is aware of inaccurate statements in the application. Such proceedings shall include notice of the grounds for denial under consideration and opportunity for hearing. At the conclusion of such proceedings, the Commission shall grant or deny such registration.

(2) If an applicant that is a nonresident security-based swap dealer or nonresident major security-based swap participant has become conditionally registered in reliance on paragraph (d)(2) of this section, the applicant will remain conditionally registered until the Commission acts to grant or deny ongoing registration in accordance with (e)(1) of this section. If none of the future actions in paragraph (d)(3) that are included in an applicant's conditional certification and opinion of counsel occurs within 24 months of the compliance date for § 240.15Fb2-1, and

there is not otherwise a basis that would provide the Commission with the assurances required by § 240.15Fb2-4(c)(1)(i) and by § 240.15Fb2-4(c)(1)(ii), the Commission may institute proceedings thereafter to determine whether ongoing registration should be denied, in accordance with paragraph (e)(1) of this section.

■ 7. Section 240.18a-5 is amended by adding paragraphs (a)(10)(iii) and (b)(8)(iii) to read as follows:

**§ 240.18a-5 Records to be made by certain security-based swap dealers and major security-based swap participants**

\* \* \* \* \*

(a) \* \* \*

(10) \* \* \*

(iii) Notwithstanding paragraph (a)(10)(i) of this section:

(A) A security-based swap dealer or major security-based swap participant is not required to make and keep current a questionnaire or application for employment executed by an associated person if the security-based swap dealer or major security-based swap participant is excluded from the prohibition in section 15F(b)(6) of the Exchange Act (15 U.S.C. 78o-10(b)(6)) with respect to such associated person; and

(B) A questionnaire or application for employment executed by an associated person who is not a U.S. person (as that term is defined in § 240.3a71-3(a)(4)(i)(A)) need not include the information described in paragraphs (a)(10)(i)(A) through (H) of this section, unless the security-based swap dealer or major security-based swap participant is required to obtain such information under applicable law in the jurisdiction in which the associated person is employed or located or obtains such information in conducting a background check that is customary for such firms in that jurisdiction and the creation or maintenance of records reflecting that information, would not result in a violation of applicable law in the jurisdiction in which the associated person is employed or located; *provided, however*, the security-based swap dealer or major security-based swap participant must comply with section 15F(b)(6) of the Exchange Act (15 U.S.C. 78o-10(b)(6)).

\* \* \* \* \*

(b) \* \* \*

(8) \* \* \*

(iii) Notwithstanding paragraph (b)(8)(i) of this section;

(A) A security-based swap dealer or major security-based swap participant is not required to make and keep current a questionnaire or application for employment executed by an associated

person if the security-based swap dealer or major security-based swap participant is excluded from the prohibition in section 15F(b)(6) of the Exchange Act (15 U.S.C. 78o–10(b)(6)) with respect to such associated person; and

(B) A questionnaire or application for employment executed by an associated person who is not a U.S. person (as that term is defined in § 240.3a71–3(a)(4)(i)(A)) need not include the information described in paragraphs (b)(8)(i)(A) through (H) of this section,

unless the security-based swap dealer or major security-based swap participant is required to obtain such information under applicable law in the jurisdiction in which the associated person is employed or located or obtains such information in conducting a background check that is customary for such firms in that jurisdiction and the creation or maintenance of records reflecting that information would not result in a violation of applicable law in the jurisdiction in which the associated person is employed or located;

*provided, however*, the security-based swap dealer or major security-based swap participant must comply with Section 15F(b)(6) of the Exchange Act (15 U.S.C. 78o–10(b)(6)).

\* \* \* \* \*

By the Commission.

Dated: December 18, 2019.

**Vanessa A. Countryman,**  
*Secretary.*

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