SULLIVAN & CROMWELL LLP

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CFTC Proposes Cross-Border Swaps Rule

CFTC Cross-Border Swaps Rule Proposal Addresses Registration Thresholds, ANE Transactions, and Substituted Compliance

SUMMARY

On December 18, the Commodity Futures Trading Commission voted 3-2 (Commissioners Rostin Behnam and Dan Berkovitz dissenting) to publish for comment a proposed rule regarding the cross-border application of the registration thresholds and certain requirements applicable to swap dealers. This proposal, if finalized, would replace interpretive guidance released by the Commission in 2013 and the never-finalized cross-border swap rules the Commission proposed in October 2016. The new proposal addresses the cross-border swaps a person would need to consider when determining whether it needs to register as a swap dealer and introduces classifications for non-U.S. swap market participants relevant to the applicability of the Commission's existing and proposed swap rules. Further, the proposal, if adopted, would provide rule-based exceptions from, and a substituted compliance process for, certain regulations applicable to registered swap dealers both at the entity and transaction-specific levels. It would also establish a framework for seeking comparability determinations with respect to applicable foreign regulatory regimes, for those rules that would otherwise be applicable to non-U.S. registered swap dealers. Due largely to the development of the global swaps supervisory landscape, the new proposal generally represents a more limited U.S. approach to the cross-border reach of Title VII (as compared to the 2013 and 2016 releases) and would allow market participants increased opportunities to take advantage of substituted compliance with foreign regulatory regimes.

BACKGROUND

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("*Dodd-Frank Act*") amended the Commodity Exchange Act ("*CEA*")[1] to establish a new regime that requires swap dealers ("*SDs*") and major swap market participants[2] (together, "*swap entities*") to register with the Commodity Futures Trading

Commission (the "*Commission*") and become subject to a regulatory regime that applies to the registered SD itself as well as the swap transactions in which it engages. In addition, Title VII imposes certain requirements on swap transactions regardless of whether an SD is a party to the transaction.

The Dodd-Frank Act amended the CEA by adding section 2(i), which provides that the provisions of Title VII do not apply to activities outside the United States unless those activities have a "direct and significant connection with activities in, or effect on, commerce of the United States" or those activities "contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion" of Title VII.[3]

To provide market participants with guidance on CEA section 2(i), following a proposal and comment period, the Commission first published interpretive guidance in July 2013 (the "*Guidance*").[4] The Guidance included the Commission's interpretation of the "direct and significant" prong of section 2(i) of the CEA. In addition, the Guidance established a general, non-binding framework for the cross-border application of certain Dodd-Frank Act registration and business conduct requirements for SDs, as well as a process for making substituted compliance determinations. At the time, the Commission was the first regulator to substantially begin the process of regulating an over-the-counter ("*OTC*") swaps market that had previously been largely unregulated, and the United States was the first country to adopt many of the OTC swap market reforms agreed to by the G20 in Pittsburgh in 2009.[5]

Following the 2013 Guidance, the Commission and its staff continued to release additional statements, guidance, no-action letters, and proposals to address the cross-border application of the Dodd-Frank Act swaps provisions. Notably, on November 14, 2013, Commission staff from the Division of Swap Dealer and Intermediary Oversight issued an advisory (the "*ANE Staff Advisory*") stating that a non-U.S. SD that regularly uses personnel or agents located in the United States to arrange, negotiate, or execute a swap with a non-U.S. person ("*ANE Transactions*") would generally be required to comply with certain Dodd-Frank Act transactional requirements.[6] However, shortly thereafter, on November 26, 2013, Commission staff issued temporary no-action relief to non-U.S. SDs registered with the Commission from the ANE Staff Advisory,[7] and that no-action relief has been regularly extended.[8]

In addition, in May 2016, the Commission issued a final rule on the cross-border application of the Commission's margin requirements for uncleared swaps (the "*Cross-Border Margin Rule*"). The Cross-Border Margin Rule detailed the circumstances under which certain SDs could satisfy the Commission's margin requirements for uncleared swaps by complying with comparable foreign margin requirements. The Cross-Border Margin Rule also established the framework the Commission uses when making comparability determinations with respect to margin regulations promulgated by non-U.S. regulators.[9]

Subsequent to the finalization of the Cross-Border Margin Rule, in October 2016, the Commission published for public comment proposed rules addressing the cross-border application of the CEA (the "*2016 Proposal*").[10] The 2016 Proposal incorporated aspects of the Cross-Border Margin Rule and addressed

when U.S. and non-U.S. persons, such as foreign consolidated subsidiaries and non-U.S. persons whose swap obligations are guaranteed by a U.S. person, would be required to include swaps or swap positions in their SD registration threshold calculation. In addition, the 2016 Proposal addressed the applicability of the Commission's rules to ANE Transactions. This 2016 Proposal was never adopted as final and is being superseded by the current proposal (the "*Proposed Rule*").[11]

THE PROPOSED RULE

I. DEFINITIONS OF U.S. PERSON, GUARANTEE, AND SIGNIFICANT RISK SUBSIDIARY

The Proposed Rule defines several key terms, including "U.S. person," "guarantee," "significant risk subsidiary," "foreign branch," and "swap conducted through a foreign branch," which are described in more detail below. Under the Proposed Rule, a market participant would be permitted to reasonably rely on a written representation from its counterparty that these definitions do or do not apply to the counterparty.[12]

A. U.S. PERSON

Under the Proposed Rule, the term "U.S. person" would mean: (1) a natural person resident in the United States; (2) a partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the United States or having its principal place of business in the United States; (3) an account (whether discretionary or non-discretionary) of a U.S. person; or (4) an estate of a decedent who was a resident of the United States at the time of death.[13]

The "principal place of business" would mean the location from which the officers, partners, or managers of the legal person primarily direct, control, and coordinate the activities of the legal person. With respect to an externally managed investment vehicle, this location would be the office from which the manager of the vehicle primarily directs, controls, and coordinates the investment activities of the vehicle.

This definition of "U.S. person" is largely consistent with the definition of "U.S. person" in the 2016 Proposal and Cross-Border Margin Rule.[14] In the Commission's view, prong (2) of the proposed definition subsumes the pension fund and trust prongs of the definition "U.S. person" in the 2016 Proposal and Cross-Border Margin Rule. However, unlike the 2016 Proposal and Cross-Border Margin Rule, the proposed definition of "U.S. person" would not include certain legal entities that are owned by one or more U.S. persons and for which such persons bear unlimited responsibility for the obligations and liabilities of the legal entity. In the Commission's view, the corporate structure that this prong is designed to capture is not one that is commonly in use in the marketplace.

This definition is also generally consistent with the "U.S. person" interpretation set forth in the Guidance, with some exceptions. First, unlike the Guidance, the Proposed Rule would not include certain legal entities that are owned by one or more U.S. persons and for which such persons bear unlimited responsibility for the obligations and liabilities of the legal entity. Second, the proposed definition does not include a

commodity pool, pooled account, investment fund, or other collective investment vehicle that is majority-owned by one or more U.S. persons. And, third, unlike the non-exhaustive "U.S. person" definition provided in the Guidance, the proposed definition of "U.S. person" is limited to persons enumerated in the rule.[15]

The Proposed Rule would permit reliance by any SD, until December 31, 2025, on any representations that were obtained to comply with the Cross-Border Margin Rule regarding the status of the counterparty as a U.S. person. The Commission also is of the view that market participants would be able to rely on representations previously obtained using the "U.S. person" definition in the Guidance given that the U.S. person definition under the Proposed Rule is narrower in scope than under the Guidance.[16]

B. GUARANTEE

Whether a swap would need to be considered when determining whether a non-U.S. person needs to register as a swap dealer and whether certain of the Commission's swap regulations would apply to a non-U.S. person's swap depends, in part, on whether the swap is "guaranteed" by a U.S. person, as described in more detail in Sections II and IV. Consistent with the Cross-Border Margin Rule, a "guarantee" under the Proposed Rule would mean an arrangement pursuant to which one party to a swap has rights of recourse against a guarantor with respect to its counterparty's obligations under the swap.[17] A party to a swap has rights of recourse against a guarantor if the party has a conditional or unconditional legally enforceable right to receive or otherwise collect, in whole or in part, payments from the guarantor with respect to its counterparty's obligations under the swap. The terms of the guarantee need not necessarily be included within the swap documentation or even otherwise reduced to writing in order to be considered a guarantee under the Proposed Rule.[18]

This definition of "guarantee" in the Proposed Rule is narrower than the one used in the Guidance. In the Guidance, the Commission interpreted the term "guarantee" to include other formal arrangements that support the non-U.S. person's ability to pay or perform its swap obligations, such as keepwells and liquidity puts, certain types of indemnity agreements, master trust agreements, liability or loss transfer or sharing agreements.[19] In proposing this narrower definition, the Commission explains that although these other arrangements can transfer risk to the U.S. financial system in a manner similar to a guarantee with a direct recourse to a U.S. person, it believes that this narrower definition "would achieve a 'more workable' framework for non-U.S. persons, particularly because this definition of 'guarantee' would be consistent with the Cross-Border Margin Rule, and therefore would not require a separate independent assessment" by market participants."[20]

C. SIGNIFICANT RISK SUBSIDIARY

The Proposed Rule would establish a new category of non-U.S. person for the purposes of the Commission's cross-border framework called a significant risk subsidiary ("*SRS*").[21] Under the Proposed Rule, an SRS would be subject to the SD registration threshold calculation as though it were a U.S. Person. The Commission notes that non-U.S. subsidiaries of U.S. persons may permit U.S. persons to accrue risk

through the swap activities of their non-U.S. subsidiaries that, in aggregate, may have a significant effect on the U.S. financial system and raise supervisory concerns in the United States through the potential impact on their ultimate U.S. parent entities.[22]

A non-U.S. person would be considered an SRS if: (1) the non-U.S. person is a "significant subsidiary"[23] of an "ultimate U.S. parent entity";[24] (2) the ultimate U.S. parent entity has more than $50 billion in global consolidated assets; and (3) the non-U.S. person is subject neither to: (a) consolidated supervision and regulation by the Federal Reserve Board as a subsidiary of a U.S. bank holding company; nor (b) capital standards and oversight by the non-U.S. person's home country regulator that are consistent with Basel III and margin requirements for uncleared swaps in a jurisdiction for which the Commission has issued a comparability determination with respect to that jurisdiction's uncleared swaps margin requirements.[25]

The Proposed Rule does not use the "foreign consolidated subsidiaries" classification that was used in the 2016 Proposal and the Cross-Border Margin Rule.[26] In practice, the definition of SRS would likely prove narrower than that of a foreign consolidated subsidiary: the Commission notes that "[o]f the 60 non-U.S. SDs that were provisionally registered with the Commission as of December 2019, the Commission believes that few, if any, would be classified as SRSs pursuant to the Proposed Rule."[27]

D. FOREIGN BRANCH AND SWAP CONDUCTED THROUGH A FOREIGN BRANCH

1. Foreign Branch

Under the Proposed Rule, the term "foreign branch" would mean an office of a U.S. person that is a bank that: (1) is located outside the United States; (2) operates for valid business reasons; (3) maintains accounts independently of the home office and of the accounts of other foreign branches, with the profit or loss accrued at each branch determined as a separate item for each foreign branch; and (4) is engaged in the business of banking or finance and is subject to substantive regulation in banking or financing in the jurisdiction where it is located. The Commission notes that the criteria are designed to prevent evasion of the Dodd-Frank Act requirement through entities establishing themselves in jurisdictions without substantive banking or financial regulation.[28]

A foreign branch would not, however, include an affiliate of a U.S. bank that is incorporated as a separate legal entity (and thus the Proposed Rule would not recognize foreign branches of U.S. persons separately form their U.S. principal for purposes of registration). As a result, if the foreign branch engages in swap activity in excess of the relevant thresholds, then the U.S. person would be required to register and the registration would cover the foreign branch as well.

2. Swap Conducted Through a Foreign Branch

Under the Proposed Rule, a "swap conducted through a foreign branch" would mean a swap entered into by a foreign branch where: (1) the foreign branch or another foreign branch is the office through which the U.S. person makes and receives payments and deliveries under the swap pursuant to a master netting or

similar trading agreement, and the documentation of the swap specifies that the office for the U.S. person is such foreign branch; (2) the swap is entered into by such foreign branch in its normal course of business; and (3) the swap is reflected in the local accounts of the foreign branch.[29] The Commission states that its intention with this definition is to identify the "key dealing" functions performed by the foreign branch outside the U.S. Further, this approach is consistent with the ISDA Master Agreement which requires that each party specify an "office" for each swap where the swap is booked and payments are made and received. The definition, similar to the foreign branch definition, contains an anti-evasion prong, in this case, stating that the swap must be entered into in the normal course of business.

II. CROSS-BORDER APPLICATION OF THE SWAP DEALER REGISTRATION THRESHOLDS

The Proposed Rule addresses the application of the de minimis threshold for SD registration to the cross-border swap dealing transactions of U.S. and non-U.S. persons. Whether a person would include a particular swap in its de minimis threshold calculation would depend on whether the person is a U.S. person, an SRS, a non-U.S. person with respect to which the swap is guaranteed by a U.S. person (a "*Guaranteed Entity*"), or a non-U.S. person who is neither an SRS nor a Guaranteed Entity (an "*Other Non-U.S. Person*").

A. U.S. PERSONS

Under the Proposed Rule, a U.S. person would include all of its swap dealing transactions in its de minimis threshold calculations without exception.

B. NON-U.S. PERSONS

Whether a non-U.S. person would need to include a swap in its de minimis threshold calculation under the Proposed Rule would depend on the type of non-U.S. person (i.e., whether the person is an SRS, a Guaranteed Entity, or an Other Non-U.S. Person) and the type of counterparty:

- **Swaps with a U.S. Person.** Under the Proposed Rule, a non-U.S. person would apply all dealing swaps with a counterparty that is a U.S. person toward its de minimis threshold calculation, except for swaps with a counterparty that is a foreign branch of a registered U.S. SD, if such swap is "conducted through a foreign branch" of the registered SD. Consistent with the position it took in the Guidance, the Commission's view is that its regulatory interest in these swaps is not sufficient to warrant creating a potential competitive disadvantage for foreign branches of U.S. SDs with respect to their foreign competitors by requiring non-U.S. persons to apply swaps entered into with the foreign branch of the U.S. SD toward the non-U.S. person's de minimis threshold calculations. Further, a swap conducted through a foreign branch of a registered SD would trigger certain Dodd-Frank Act transactional requirements, including margin requirements, and such swap activity would not be conducted outside the Dodd-Frank Act regime in any event. In addition, such swap activity would potentially be subject to other foreign regulatory regimes' transactional requirements.[30]
- **Swaps Subject to a Guarantee.** The Proposed Rule would require a non-U.S. person to apply to its de minimis threshold calculation swap dealing transactions where its obligations under the swaps are subject to a guarantee by a U.S. person. As a result of the guarantee, the U.S. guarantor effectively bears the exposure arising from the swap as if it had entered into the swap directly and thus the swap obligations of a Guaranteed Entity are identical, in relevant aspects, to a swap entered into directly by a U.S. person.[31] Further, the Commission expressed a

concern that treating a Guaranteed Entity any differently than a U.S. person could incentivize U.S. persons to conduct their dealing business with non-U.S. persons subject to a guarantee from a U.S. person to avoid the application of the Dodd-Frank Act and SD regulatory requirements.[32] Under the Proposed Rule, a non-U.S. person must also apply dealing swaps with a Guaranteed Entity to its SD de minimis threshold calculation with two exceptions:

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

The two exceptions are intended to address those situations where the risk of the swap between the non-U.S. person and the Guaranteed Entity would be otherwise managed under the Title VII framework or is primarily outside the U.S. financial sector.[33]

- **Swaps by and with a Significant Risk Subsidiary.** Under the Proposed Rule, an SRS would include all of its dealing swaps in its de minimis threshold calculation without exception. However, an Other Non-U.S. Person would not be required to apply a dealing swap with an SRS toward its de minimis threshold calculation, unless the SRS was also a Guaranteed Entity (and no exception applied). The Commission notes that requiring the Other Non-U.S. Person to apply the swap towards the de minimis threshold calculation could cause the Other Non-U.S. Person to stop engaging in swap activities with the SRS. The Commission believes it is important to ensure that an SRS, particularly a commercial entity, continues to have access to swap liquidity from Other Non-U.S. Persons for hedging and other purposes.

The Commission's release includes a table summarizing the cross-border application of the SD de minimis threshold,[34] which is reproduced as Table 1 in Annex A below.

C. AGGREGATION REQUIREMENT

Under the Proposed Rule and consistent with the Guidance, a U.S. or non-U.S. person would aggregate all swaps connected with its dealing activity with those of persons controlling, controlled by, or under common control with the person to the extent that these affiliated persons are themselves required to include those swaps in their own de minimis threshold calculations, unless the affiliated person is itself a registered SD.[35]

As the Commission explains, when a group of affiliated persons meets the de minimis threshold in the aggregate, one or more affiliates would have to register as an SD so that the relevant swap dealing activity of the unregistered affiliates remains below the threshold in the aggregate. The Commission believes that its approach would address the concern that an affiliated group of U.S. and non-U.S. persons engaged in swap dealing transactions with a significant connection to the United States may not be required to register solely because such swap dealing activities are divided among affiliates that each individually falls below the de minimis threshold.

D. EXCHANGE-TRADED AND CLEARED SWAPS

Under the Proposed Rule, a non-U.S. person that is not a Guaranteed Entity or SRS would be permitted to exclude from its de minimis threshold calculation any swap that it anonymously enters into on a designated contract market ("*DCM*"), a swap execution facility ("*SEF*") that is registered or exempt from registration

with the Commission, or a registered or exempt foreign board of trade ("*FBOT*"), if such swap is also cleared through a registered or exempt derivatives clearing organization ("*DCO*").

III. ANE TRANSACTIONS

The ANE Staff Advisory provided that a non-U.S. SD would generally be required to comply with transaction-level requirements for SDs for ANE Transactions. As noted above, shortly after issuing the ANE Staff Advisory, the Commission provided no-action relief with respect to the ANE Staff Advisory which remains in effect.[36] In the 2016 Proposal, the Commission effectively proposed to formally adopt the position taken in the ANE Staff Advisory and apply certain transaction-level requirements to ANE transactions. However, the Proposed Rule would revise the Commission's approach. Whether a transaction is an ANE Transaction would not formally factor into any determinations made under the Proposed Rule. Accordingly, under the Proposed Rule, all foreign-based swaps entered into between a non-U.S. SD and a non-U.S. person would be treated the same regardless of whether the swap is an ANE Transaction, subject presumably to the CFTC's anti-evasion authority.[37]

The proposed treatment of ANE Transactions contrasts with the SEC's, which has taken an expansive approach under which ANE Transactions count toward the security-based swap dealer de minimis registration threshold and are generally subject to Title VII requirements.[38] However, recently, the SEC has adopted rule amendments and guidance regarding ANE Transactions under which (i) personnel that provide "market color" regarding security-based swaps are not involved in ANE Transactions and (ii) majority-owned affiliates do not need to count ANE Transactions in their registration threshold if the ANE Transactions are performed by personnel associated with an affiliated entity that is registered with the SEC as a security-based swap dealer or a broker, subject to certain limitations.[39]

IV. PROPOSED EXCEPTIONS FROM GROUP B AND GROUP C REQUIREMENTS, SUBSTITUTED COMPLIANCE FOR GROUP A AND GROUP B REQUIREMENTS, AND COMPARABILITY DETERMINATIONS

The Dodd-Frank Act and the Commission's regulations establish a broad range of requirements applicable to SDs, including requirements regarding risk management and internal and external business conduct. SDs are subject to all of these regulations, whether or not they are U.S. persons. However, the Proposed Rule would include certain exceptions from, and a substituted compliance process for, cross-border regulation of registered SDs. The Proposed Rule would also create a framework for comparability determinations that, according to the Commission, "emphasizes a holistic, outcomes-based approach."

A. CLASSIFICATION AND APPLICATION OF CERTAIN REGULATORY REQUIREMENTS – GROUP A, GROUP B, AND GROUP C REQUIREMENTS

The Guidance had applied a bifurcated approach to the classification of certain regulatory requirements applicable to swap entities based on whether the requirement applies to the firm as a whole or to the individual swap or trading relationship. The Proposed Rule would instead classify these regulations as

group A, group B, and group C requirements for purposes of determining the availability of certain exceptions or substituted compliance. The group A requirements generally are intended to ensure that swap entities implement and maintain a comprehensive and robust system of internal controls to ensure the financial integrity of the firm. The group B requirements generally relate to risk mitigation and the maintenance of good recordkeeping and business practices. The group C requirements include the external business conduct standards governing the conduct of SDs in dealing with their swap counterparties. The table below summarizes the specific requirements applicable to each group:

Group A Requirements	Group B Requirements	Group C Requirements
Rule 3.3 - Chief compliance officer Rule 23.201 - Required Records Rule 23.203 - Records; Retention and Inspection Rule 23.600 - Risk Management Program for Swap Dealers and Major Swap Participants Rule 23.601 - Monitoring of Position Limits Rule 23.602 - Diligent Supervision Rule 23.603 - Business Continuity and Disaster Recovery Rule 23.605 - Conflicts of Interest Policies and Procedures Rule 23.606 - General Information: Availability for Disclosure and Inspection Rule 23.607 - Antitrust Considerations Rule 23.609 - Clearing Member Risk Management	Rule 23.202 - Daily Trading Records Rule 23.501 - Swap Confirmation Rule 23.502 - Portfolio Reconciliation Rule 23.503 - Portfolio Compression Rule 23.504 - Swap Trading Relationship Documentation	Rules 23.400-451 - Business Conduct Standards for Swap Dealers and Major Swap Participants Dealing with Counterparties, Including Special Entities

Under the Proposed Rule, the Commission takes a different approach with respect to each group of requirements. With respect to the group A requirements, the Commission believes that these requirements would be impractical to apply only to specific transactions or counterparty relationships and are most effective when applied consistently across the entire enterprise; as a result, all swap entities, whether domestic or foreign, would be subject to the group A requirements under the Proposed Rule.[40] Conversely, the Commission believes that the group B requirements can be applied on a bifurcated basis between

domestic and foreign transactions or counterparty relationships and, thus, do not need to be applied uniformly across an entire enterprise.[41] Finally, in the Commission's view, the group C requirements focus on customer protection and have a more attenuated link to, and are therefore distinguishable from, systemic and market-oriented protections in the group A and group B requirements. According to the Commission, foreign jurisdictions are likely to have a significant interest in the type of standards that would be applicable to transactions with such non-U.S. persons and foreign branches within their jurisdiction, and so it is generally appropriate to defer to such jurisdictions in applying, or not applying, such standards to foreign-based swaps with foreign counterparties.[42]

B. PROPOSED EXCEPTIONS

The Commission is proposing four exceptions from certain Commission regulations which would be available only to "foreign-based swaps," which the Proposed Rule would define as either (1) a swap by a non-U.S. swap entity, except for a swap conducted through a U.S. branch; or (2) a swap conducted through a foreign branch. The first exception the Commission is proposing is an exception from certain group B and C requirements for certain anonymous, exchange-traded, and cleared foreign-based swaps ("*Exchange-Traded Exception*"). Second, the Commission is proposing an exception from the group C requirements for certain foreign-based swaps with foreign counterparties ("*Foreign Swap Group C Exception*").[43] Third, the Commission is proposing an exception from the group B requirements for the foreign-based swaps of certain non-U.S. swap entities with certain foreign counterparties ("*Non-U.S. Swap Entity Group B Exception*"). Fourth, the Commission is proposing an exception from the group B requirements for certain foreign-based swaps of foreign branches of U.S. swap entities with certain foreign counterparties, subject to certain limitations, including a quarterly cap on the amount of such swaps ("*Foreign Branch Group B Exception*"). The Commission notes, however, that notwithstanding these exceptions, swap entities would remain subject to the CEA and Commission regulations, including the prohibition on the employment or attempted employment of manipulative or deceptive devices found in § 180.1 of the Commission's regulations.[44]

The relevant exceptions are summarized below:

Exception	Type of Swap	Entity type	Counterparty	Requirements Exempted
Exchange-Traded Exception	Foreign-based swap entered into on a DCM, a registered or exempt SEF, or a registered or exempt FBOT, where cleared through a	Non-U.S. swap entity and foreign branch of a U.S. swap entity	Any counterparty for which the swap entity does not know the identity of the counterparty to the swap prior to execution.	Group B (except daily trading records) Group C requirements

Exception	Type of Swap	Entity type	Counterparty	Requirements Exempted
	registered or exempt DCO			
Foreign Swap Group C Exception	Foreign-based swap	Non-U.S. swap entity and foreign branch of a U.S. swap entity	Foreign counterparty	Group C requirements
Non-U.S. Swap Entity Group B Exception	Foreign-based swap	Non-U.S. entity that is an Other Non-U.S. Person	Foreign counterparty (other than a foreign branch) that is an Other Non-U.S. Person	Group B requirements
Foreign Branch Group B Exception	Foreign-based swap	Foreign branch of a U.S. swap entity	Foreign counterparty (other than a foreign branch) that is an Other Non-U.S. Person	Group B requirements (except when substituted compliance is available and subject to gross notional limitations)

1. Exchange-Traded Exception

With respect to its foreign-based swaps, each non-U.S. swap entity and foreign branch of a U.S. swap entity would be excepted from the group B requirements, other than daily trading records requirements, [45] and the group C requirements with respect to any swap entered into on a DCM, a registered or exempt SEF, or a registered or exempt FBOT, where the swap is cleared through a registered or exempt DCO, and the swap entity does not know the identity of the counterparty prior to execution. The "exempt" status for this purpose refers to an active exemption from CFTC registration rather than a venue that is exempt solely based on the fact that it is not within the CFTC's jurisdiction.

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

Of the remaining group B requirements, the portfolio reconciliation and compression and swap trading relationship documentation requirements would not apply to cleared DCM, SEF, or FBOT transactions because the Commission regulations that establish those requirements do not apply to cleared transactions.

For the last group B requirement, the daily trading records requirement, the Commission believes that, as a matter of international comity and recognizing the supervisory interests of foreign regulators who may have their own trading records requirements, it is appropriate to except such foreign-based swaps from certain of the Commission's daily trading records requirements.

However, the Commission believes that the daily trading records requirements of §§ 23.202(a) through (a)(1) should continue to apply, as it believes that all swap entities should be required to maintain, among other things, sufficient records to conduct a comprehensive and accurate trade reconstruction for each swap.

Additionally, given that this exception is predicated on anonymity, many of the group C requirements would be inapplicable.

2. Foreign Swap Group C Exception

Under the Proposed Rule, each non-U.S. swap entity and foreign branch of a U.S. swap entity would be excepted from the group C requirements with respect to its foreign-based swaps with foreign counterparties. The Commission notes that foreign regulators may have a relatively stronger supervisory interest in regulating such swaps in relation to the group C requirements as they relate to counterparty protections in the context of local market practices.[46]

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

Under the Proposed Rule, a non-U.S. swap entity that is an Other Non-U.S. Person would be excepted from the group B requirements with respect to any foreign-based swap with a foreign counterparty that is also an Other Non-U.S. Person. In the circumstance where no party to the foreign-based swap is a U.S. person, guaranteed by a U.S. person, or an SRS, and, the particular swap is a foreign-based swap, notwithstanding that one or both parties to such swap may be a swap entity, the Commission believes that foreign regulators may have a relatively stronger supervisory interest in the subject matter.[47]

4. Foreign Branch Group B Exception

Under the Proposed Rule, each foreign branch of a U.S. swap entity would be excepted from the group B requirements, with respect to any foreign-based swap with a foreign counterparty that is an Other Non-U.S. Person, subject to certain limitations. Specifically: (1) the exception would not be available with respect to any group B requirement for which substituted compliance is available for the relevant swap (see Part C below); and (2) in any calendar quarter, the aggregate gross notional amount of swaps conducted by a

swap entity in reliance on the exception may not exceed five percent of the aggregate gross notional amount of all its swaps in that calendar quarter (presumably across the swap entity, including its foreign branches).[48]

The Commission considers the Foreign Branch Group B Exception appropriate because U.S. swap entities' activities through foreign branches in these markets, though not significant in volume in many cases, may nevertheless be an integral element of a U.S. swap entity's global business. The Commission's goal with respect to this exception is to preserve liquidity in the emerging markets in which it expects this exception to be utilized. Further, because of the proposed five percent cap on the use of the exception, the Commission believes that the swap activity that would be excepted from the group B requirements under the Proposed Rule would not raise significant supervisory concerns.[49]

The Commission's release includes tables summarizing the cross-border application of the group B and group C requirements in consideration of these exceptions,[50] which are reproduced as Table 2 (group B requirements) and Table 3 (group C requirements) in Annex A below.

C. SUBSTITUTED COMPLIANCE

The Commission believes that all U.S. swap entities must be fully subject to the Dodd-Frank Act requirements, without regard to whether their counterparty is a U.S. or non-U.S. person, as these swap activities inherently have a "direct and significant" connection with activities in, or effect on, U.S. commerce.[51] However, the Commission recognizes that non-U.S. swap entities' activities with non-U.S. persons may sometimes have a more attenuated nexus to U.S. commerce and that foreign jurisdictions also have a supervisory interest in such activity. As a result, the Commission notes that substituted compliance may be appropriate for non-U.S. swap entities and foreign branches of U.S. swap entities in certain circumstances.[52]

The Proposed Rule includes a substituted compliance regime with respect to the group A and group B requirements that builds upon the Commission's current substituted compliance framework.[53]

1. Proposed Substituted Compliance Framework for the Group A Requirements

Because the group A requirements are generally implemented on a firm-wide basis in order to effectively address enterprise risk, the Commission believes it is not practical to limit substituted compliance for the group A requirements to only those transactions involving non-U.S. persons. Substituted compliance, if available, would apply in the context of transactions with both U.S. and non-U.S. persons. That is, and in an effort to further international comity, the Proposed Rule would permit a non-U.S. swap entity to avail itself of substituted compliance with respect to the group A requirements for all of its swap business where the non-U.S swap entity is subject to comparable regulation in its home jurisdiction.[54]

2. Proposed Substituted Compliance Framework for the Group B Requirements

The group B requirements are more closely tied to local market conventions and can be effectively implemented on a transaction-by-transaction or relationship basis. It is therefore practicable, the Commission believes, to allow substituted compliance for group B requirements for transactions with non-U.S. persons. Accordingly, under the Proposed Rule, a non-U.S. swap entity or foreign branch of a U.S. swap entity could avail itself of substituted compliance for the group B requirements in certain circumstances, depending on the nature of its counterparty. Specifically, the Proposed Rule would allow a non-U.S. swap entity (unless transacting though a U.S. branch), or a U.S. swap entity transacting through a foreign branch, to avail itself of substituted compliance with respect to the group B requirements for swaps with foreign counterparties.[55]

Table 2 in Annex A, in addition to summarizing the cross-border application of the group B requirements in consideration of the exceptions described above in Section IV.C, also summarizes when substituted compliance is available for the group B requirements.

D. COMPARABILITY DETERMINATIONS

The Commission is proposing to implement a process pursuant to which it would conduct comparability determinations using "a flexible outcomes-based approach that emphasizes comparable regulatory outcomes over identical regulatory approaches." According to the Commission, the proposed approach is similar to the approach adopted in the Guidance and in the Cross-Border Margin Rule.

Under the Proposed Rule, in assessing comparability, the Commission may consider any factor it deems appropriate, which may include: (1) the scope and objectives of the relevant foreign jurisdiction's regulatory standards; (2) whether, despite differences, a foreign jurisdiction's regulatory standards achieve comparable regulatory outcomes to the Commission's corresponding requirements; (3) the ability of the relevant regulatory authority or authorities to supervise and enforce compliance with the relevant foreign jurisdiction's regulatory standards; and (4) whether the relevant foreign jurisdiction's regulatory authorities have entered into a memorandum of understanding or similar cooperative arrangement with the Commission regarding the oversight of swap entities.[56] The Proposed Rule would also enable the Commission to consider other relevant factors, including whether a foreign regulatory authority has issued a reciprocal comparability determination with respect to the Commission's corresponding regulatory requirements.[57] Further, the Commission may impose any terms and conditions on a comparability determination that it deems appropriate.[58]

Under the Proposed Rule, a comparability determination need not contain a standalone assessment of comparability for each relevant regulatory requirement, so long as it clearly indicates the scope of regulatory requirements that are covered by the determination. Notably, while in the Guidance the Commission repeatedly emphasizes that it will issue comparability determinations if it finds that a foreign jurisdiction's

regulatory standards are both "comparable with" and "*as comprehensive as*" the Commission's regulations,[59] the Proposed Rule does not include the "as comprehensive as" prong and allows the Commission to issue a comparability determination if it finds that the "foreign jurisdiction's standards are comparable to the Commission's corresponding requirements."[60]

Under the Proposed Rule, the Commission could undertake a comparability determination on its own initiative. Alternatively, a comparability determination could be requested by: (1) swap entities that are eligible for substituted compliance; (2) trade associations whose members are such swap entities; or (3) foreign regulatory authorities that have direct supervisory authority over such swap entities and are responsible for administering the relevant swap standards in the foreign jurisdiction.[61] Applicants would be required to furnish certain information to the Commission and would be expected to provide an explanation as to how any such differences may nonetheless achieve comparable outcomes.[62]

Previously issued comparability determinations "would remain effective pursuant to their terms" if the Proposed Rule is adopted.[63]

V. RECORDKEEPING

Under the Proposed Rule, a SD would be required to create a record of its compliance with all provisions of the Proposed Rule, and retain those records in accordance with § 23.203.[64]

VI. REQUEST FOR COMMENT

The Commission is requesting comments on various aspects of the proposal. Comments are due by March 9, 2020.

* * *

ENDNOTES

[1] 7 U.S.C. § 1 *et seq*.

[2] Generally, a major swap participant is any person that is not a swap dealer but maintains substantial swaps positions or whose outstanding swaps create substantial counterparty exposure, as measured by certain calculations as set forth in CFTC rules. *See* 17 C.F.R. § 1.3. The CFTC's swap regulations also regulate major swap participants, as would the proposed rule. However, because there are currently no major swap participants, this memo focuses on swap dealers.

[3] 7 U.S.C. § 2(i).

[4] Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 FR 45292 (July 26, 2013).

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

[6] CFTC Staff Advisory No. 13-69, Applicability of Transaction-Level Requirements to Activity in the United States (Nov. 14, 2013).

[7] CFTC Staff Letter No. 13-71, No-Action Relief: Certain Transaction-Level Requirements for Non-U.S. Swap Dealers (Nov. 26, 2013).

[8] CFTC Letter Nos. 14-01, 14-74, 14-140, 15-48, 16-64, and 17-36.

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

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

[11] Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 FR 952 (Jan. 8, 2020) *available at* https://www.cftc.gov/sites/default/files/2020/01/2019-28075a.pdf.

[12] 85 FR 958-59.

[13] This is the same definition of "U.S. person" used by the SEC in its cross-border securities-based swap regulations.

[14] *See* 81 FR 71948-49 and 81 FR 34821-22.

[15] 85 FR 961. *See also* Guidance at 453301-02.

[16] 85 FR 962.

[17] 85 FR 963.

[18] 85 FR 963.

[19] 85 FR 963. *See also* Guidance at 45318.

[20] 85 FR 963.

[21] In exchange, the Proposed Rule drops the "foreign consolidated subsidiaries" classification used in the 2016 Proposal and the Cross-Border Margin Rule, which, in turn, displaced the "affiliate conduit" classification used in the Guidance.

[22] 85 FR 964.

[23] In order for a non-U.S. subsidiary to be considered an SRS, the subsidiary would need to be a "significant" subsidiary. The Proposed Rule includes a set of quantitative significance tests based on the subsidiary's equity capital, revenue, and assets relative to its ultimate U.S. parent entity. Specifically, the term "significant subsidiary" would mean a subsidiary where: (1) the three-year rolling average of the subsidiary's equity capital is equal to or greater than five percent of the three-

year rolling average of its ultimate U.S. parent entity's consolidated equity capital; (2) the three-year rolling average of the subsidiary's revenue is equal to or greater than 10 percent of the three-year rolling average of its ultimate U.S. parent entity's consolidated revenue; or (3) the three-year rolling average of the subsidiary's assets are equal to or greater than 10 percent of the three-year rolling average of its ultimate U.S. parent entity's consolidated assets. An entity would be a significant subsidiary only if it passes at least one of these tests. 85 FR 965.

[24] The term "parent entity" under the Proposed Rule would mean any entity in a consolidated group that has one or more subsidiaries in which the entity has a controlling interest, in accordance with U.S. GAAP. A non-U.S. person's "ultimate U.S. parent entity" would be the U.S. parent entity that is not a subsidiary of any other U.S. parent entity. 85 FR 965.

[25] 85 FR 964. In the Commission's view, an entity that meets either of the two exceptions in prong (3) would be subject to a level of regulatory oversight that is sufficiently comparable to the Dodd-Frank Act swap regime with respect to prudential oversight. Further, such an approach is consistent with the Commission's desire to show deference to non-U.S. regulators whose requirements are comparable to the CFTC's requirements. The Commission also notes that, for margin purposes, the Commission has issued a number of determinations that entities can look to in order to determine if they satisfy this aspect of the exception, and, for capital standards and oversight consistent with Basel III, entities can look to whether the Bank for International Settlements has determined the jurisdiction is in compliance as of the relevant Basel Committee on Banking Supervision deadline set forth in its most recent progress report.

[26] Per the 2016 Proposal, the term "Foreign Consolidated Subsidiary" ("*FCS*") would mean "a non-U.S. person in which an ultimate parent entity that is a U.S. person has a controlling financial interest, in accordance with U.S. generally accepted accounting principles ('U.S. GAAP'), such that the U.S. ultimate parent entity includes the non-U.S. person's operating results, financial position and statement of cash flows in the U.S. ultimate parent entity's consolidated financial statements, in accordance with U.S. GAAP" and, like an SRS, was intended to identify "non-U.S. persons whose swap activities present a greater supervisory interest relative to other non-U.S. market participants, due to the nature and extent of the FCS's relationship with its U.S. ultimate parent." 81 FR 71950. In turn, the FCS concept would have replaced the "affiliate conduit" classification used in the Guidance. Per the Guidance, an "affiliate conduit encompasses those entities that function as a conduit or vehicle for U.S. persons conducting swaps transactions with third-party counterparties." 78 FR 45358.

[27] 85 FR 992.

[28] 85 FR 966-67.

[29] 85 FR 967.

[30] 85 FR 971-72.

[31] 85 FR 972.

[32] 85 FR 972.

[33] 85 FR 972.

[34] 85 FR 999.

[35] 85 FR 972-73.

[36] CFTC Letter Nos. 13-71, 14-01, 14-74, 14-140, 15-48, 16-64, and 17-36.

[37] 85 FR 978.

[38] *See, e.g.*, Security-Based Swap Transactions Connected with a Non-U.S. Person's Dealing Activity That Are Arranged, Negotiated, or Executed by Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent; Security-Based Swap Dealer De Minimis Exception, 81 FR 8598 (Feb. 19, 2016).

ENDNOTES (CONTINUED)

39 SEC Release No. 34-87780, "Rule Amendments and Guidance Addressing Cross-Border Application of Certain Security-Based Swap Requirements" (Dec. 18, 2019).

40 85 FR 980.

41 85 FR 981.

42 85 FR 982.

43 For the purposes of the Proposed Rule, a "foreign counterparty" means (1) a non-U.S. person, except with respect to a swap conducted through a U.S. branch of that non-U.S. person; or (2) a foreign branch where it enters into a swap in a manner that satisfies the definition of a swap conducted through a foreign branch. 85 FR 968.

44 17 CFR § 180.1

45 *See* 17 CFR 23.202(a).

46 85 FR 983-84. The Commission notes, however, when a swap involves at least one party that is a U.S. person or is a swap that is conducted through a U.S. branch, it believes it retains a strong supervisory interest in regulating and enforcing the group C requirements under the Title VII framework.

47 85 FR 984.

48 85 FR 984. For example, if a swap entity were to enter into $10 billion in aggregate gross notional of swaps in a calendar quarter, no more than $500 million in aggregate gross notional of such swaps would be eligible for the Foreign Branch Group B Exception.

49 85 FR 984.

50 85 FR 1000-01.

51 85 FR 985.

52 85 FR 985.

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

54 85 FR 985.

55 85 FR 985.

56 85 FR 986-87.

57 85 FR 987.

58 85 FR 987.

59 78 FR 45342-46.

60 85 FR 1005.

61 85 FR 987.

62 85 FR 987.

63 85 FR 986.

64 85 FR 987.

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CONTACTS

New York		
Robert E. Buckholz	+1-212-558-3876	buckholzr@sullcrom.com
Whitney A. Chatterjee	+1-212-558-4883	chatterjeew@sullcrom.com
Donald R. Crawshaw	+1-212-558-4016	crawshawd@sullcrom.com
David J. Gilberg	+1-212-558-4680	gilbergd@sullcrom.com
Joseph A. Hearn	+1-212-558-4457	hearnj@sullcrom.com
Ryne V. Miller	+1-212-558-3268	millerry@sullcrom.com
Kenneth M. Raisler	+1-212-558-4675	raislerk@sullcrom.com
Robert W. Reeder III	+1-212-558-3755	reederr@sullcrom.com
Tracey E. Russell	+1-212-558-3289	russellt@sullcrom.com
Rebecca J. Simmons	+1-212-558-3175	simmonsr@sullcrom.com
Frederick Wertheim	+1-212-558-4974	wertheimf@sullcrom.com
Washington, D.C.		
Eric J. Kadel, Jr.	+1-202-956-7640	kadelej@sullcrom.com
Robert S. Risoleo	+1-202-956-7510	risoleor@sullcrom.com
Los Angeles		
Patrick S. Brown	+1-310-712-6603	brownp@sullcrom.com
Alison S. Ressler	+1-310-712-6630	resslera@sullcrom.com
Palo Alto		
Sarah P. Payne	+1-650-461-5669	paynesa@sullcrom.com
John L. Savva	+1-650-461-5610	savvaj@sullcrom.com

London		
Kathryn A. Campbell	+44-20-7959-8580	campbellk@sullcrom.com
John Horsfield-Bradbury	+44-20-7959-8491	horsfieldbradburyj@sullcrom.com
Brussels		
Michael Rosenthal	+32-2896-8001	rosenthalm@sullcrom.com
Paris		
William D. Torchiana	+33-1-7304-5890	torchianaw@sullcrom.com
Frankfurt		
Krystian Czerniecki	+49-69-4272-5525	czernieckik@sullcrom.com
Tokyo		
Izumi Akai	+81-3-3213-6145	akaii@sullcrom.com
Keiji Hatano	+81-3-3213-6171	hatanok@sullcrom.com
Hong Kong		
Garth W. Bray	+852-2826-8691	brayg@sullcrom.com
Chun Wei	+852-2826-8666	weic@sullcrom.com
Australia		
Waldo D. Jones Jr.	+61-2-8227-6702	jonesw@sullcrom.com

ANNEX A: INDICATIVE CHARTS

Table 1: Cross-Border Application of the SD De Minimis Threshold

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

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

Table 2: Cross-Border Application of the Group B Requirements in Consideration of Related Exceptions and Substituted Compliance

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

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

Table 3: Cross-Border Application of the Group C Requirements in Consideration of Related Exceptions

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

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