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CFTC Cross-Border Swaps Rule

Review of CFTC Final Rule Covering Cross-Border Swaps Registration Thresholds, ANE Transactions, and Substituted Compliance

SUMMARY

On July 23, 2020, the Commodity Futures Trading Commission (the "CFTC" or the "Commission") held an open meeting at which it voted 3-2 (with Commissioners Behnam and Berkovitz dissenting) to adopt a final rule regarding the cross-border application of the registration thresholds and certain requirements applicable to swap dealers and major swap participants in connection with cross-border transactions (the "Final Rule"). The Final Rule came into effect on November 13, 2020, and compliance will be required in September 2021. The Final Rule largely follows the rule proposed by the Commission on December 18, 2019 (the "Proposed Rule"), and replaces existing interpretive guidance released by the Commission in 2013 and the never-finalized cross-border swap rules the Commission proposed in October 2016.

Specifically, the Final Rule addresses the cross-border application of registration thresholds and certain requirements applicable to swap dealers ("SDs") and major swap participants ("MSPs"), and establishes a formal process for requesting comparability determinations by the Commission for non-U.S. regulatory regimes, which could relieve SDs and MSPs from compliance with certain such requirements. The Final Rule adopts a risk-based approach that the Commission believes will support the principles of international comity while maintaining Commission authority over significant risks. The Commission also expects the Final Rule to foster greater liquidity and competitive markets, promote enhanced regulatory cooperation, and improve the global harmonization of swap regulation.

Because the Final Rule as adopted is largely consistent with the Proposed Rule, this memorandum focuses on the significant changes made to the Proposed Rule by the Final Rule. The Sullivan & Cromwell memorandum to clients reviewing the Proposed Rule is available here.

BACKGROUND

Title VII of the Dodd-Frank Act, through amendments to the Commodity Exchange Act (the "CEA"), required SDs and MSPs (together, "swap entities") to register with the Commission and subjects swap entities to a regulatory regime that applies to the registered entities themselves as well as to the swap transactions in which they engage. Title VII also imposed certain requirements on swap transactions regardless of whether a registered swap entity is a party to the transactions. The Dodd-Frank Act added section 2(i) to the CEA, which generally excludes from the reach of Title VII swap activities occurring outside the United States. However, section 2(i) states that Title VII's requirements apply to any foreign activities that have a "direct and significant connection with activities in, or effect on, commerce of the United States" and to foreign activities that "contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion" of Title VII.[1]

Prior to the Proposed Rule, the Commission took several significant steps to provide market participants with guidance on the scope of CEA section 2(i) and, in particular, its applicability to non-U.S. swap dealers and non-U.S. transactions.

First, following a proposal and comment period, the Commission published interpretive guidance in July 2013 (the "2013 Guidance").[2] The 2013 Guidance included the Commission's interpretation of the "direct and significant" prong of section 2(i). In addition, the 2013 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 in the world to substantially begin the process of regulating the previously largely unregulated over-the-counter ("OTC") swap market, 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.[3]

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 ("DSIO")—which, as of October 2020, has been merged into the Market Participants Division ("MPD")—issued an advisory (the "ANE Staff Advisory") addressing transactions in which a non-U.S. SD uses personnel or agents located in the U.S. to arrange, negotiate, or execute a swap with a non-U.S. person ("ANE Transactions"). The ANE Staff Advisory stated that non-U.S. SDs that regularly engaged in such ANE Transactions would generally be required to comply with certain Dodd-Frank requirements.[4] 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,[5] and that no-action relief was regularly extended.[6]

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.[7] However, the Cross-Border Margin Rule is applicable only to the Commission's margin requirements and not other aspects of the operation of swap entities or their dealings with counterparties.

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").[8] The 2016 Proposal incorporated aspects of the Cross-Border Margin Rule and addressed the circumstances in which 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 was superseded by the Proposed Rule.[9]

On December 18, 2019, the Commission published for public comment the Proposed Rule. In the Proposed Rule, the Commission also withdrew the 2016 Proposal, stating that the Proposed Rule reflected the Commission's current views on the matters addressed in the 2016 Proposal, which had evolved since the 2016 Proposal as a result of market and regulatory developments in the swap markets and in the interest of international comity.[10]

The Commission voted to adopt the Final Rule on July 23, 2020.[11]

THE FINAL RULE

I. SIGNIFICANT DEFINITIONS

The Final Rule defines several key terms, including "U.S. person," "guarantee," "significant risk subsidiary," "foreign branch," and "swap conducted through a U.S. branch."[12] These definitions were largely adopted as proposed with certain modifications and clarifications, as described in more detail below. The Final Rule adopted the Proposed Rule's stance that a market participant is permitted to reasonably rely on a written representation from its counterparty, provided that the swap entity has no reason to believe that the representations are not accurate, regarding its status and the applicability of these definitions to the counterparty.[13]

A. U.S. PERSON

The Commission adopted the definition of "U.S. person" as proposed, with a few clarifications. The Final Rule uses "a 'territorial' concept" of personhood[14] and defines a non-natural person as a U.S. person if it has its principal place of business in the United States or if it is organized, incorporated, or established under the laws of the United States.[15] The Final Rule defines a "principal place of business" as the location from which the natural persons who direct, control and coordinate the activities of the business operate (i.e., the place of corporate control) or, in the case of an externally managed investment vehicle, the location from which the vehicle's manager manages the investment activities of the vehicle.[16]

The Commission chose a definition it believes is substantially coextensive with the one used by the Securities and Exchange Commission (the "SEC") and will therefore reduce complexities and compliance costs for those entities whose swap activities are regulated by both commissions.[17]

The Commission excluded from the Final Rule a prong present in the 2013 Guidance definition of a U.S. person that included those commodity pools, pooled accounts, investment funds, and other collective investment vehicles majority-owned by U.S. persons with foreign principal places of business. In doing so, the Commission both used a definition that was consistent with the one used by the SEC and agreed with commenters who said the prong was unmanageable and of limited utility.[18]

B. GUARANTEE

The definition of "guarantee" in the Final Rule maintains the narrow approach set out in the Proposed Rule with certain modifications and clarifications. The Final Rule defines a "guarantee" as an arrangement in which "one party to a swap has rights of recourse against a guarantor, with respect to its counterparty's obligations under the swap," with "rights of recourse" meaning a legally enforceable right to collect payments from the guarantor.[19] In contrast to the Proposed Rule, the Commission is interpreting "guarantee" in a manner similar to the SEC.[20] Specifically, when a non-U.S. person's counterparty has recourse to a U.S. person for the performance of the non-U.S. person's obligations under a swap by virtue of the U.S. person's unlimited responsibility for the non-U.S. person, such an arrangement is considered a guarantee, and the non-U.S. person is required to include the swap in its SD and MSP threshold calculations, respectively.

C. SIGNIFICANT RISK SUBSIDIARY

The Final Rule adopts the proposed definition of "significant risk subsidiary" with modifications and establishes for the purposes of the Commission's cross-border framework a new type of non-U.S. person called a significant risk subsidiary ("SRS").[21] Under the Final Rule, an SRS is subject to the SD registration threshold calculation as though it were a U.S. person.

Under the Proposed Rule, a non-U.S. person would be considered an SRS if: (1) the non-U.S. person is a "significant subsidiary" of an "ultimate U.S. parent entity";[22] (2) the "ultimate U.S. parent entity" has more than $50 billion in global consolidated assets, as determined in accordance with U.S. generally accepted accounting principles at the end of the most recently completed fiscal year; and (3) the non-U.S. person is not subject to either: (a) consolidated supervision and regulation by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") as a subsidiary of a U.S. bank holding company; or (b) capital standards and oversight by the non-U.S. person's home country regulator that are consistent with the Basel Committee on Banking Supervision's "International Regulatory Framework for Banks" ("Basel III") and margin requirements for uncleared swaps in a jurisdiction for which the Commission has issued a comparability determination (the "CFTC Margin Determination") with respect to uncleared swap margin requirements.

As discussed further below, the Final Rule deviates from the Proposed Rule by (a) adding intermediate holding companies ("IHCs") to the section 23.23(a)(13)(i) exclusion for those companies that are subject to consolidated supervision and regulation by the Federal Reserve Board, (b) making a clarifying revision to the "margin requirements" aspect of section 23.23(a)(13)(ii) and (c) making clarifying revisions to the definition of "subsidiary."

(a) Deviating from the Proposed Rule, the Commission notes that the SRS concept is not intended to reach subsidiaries of holding companies that are subject to consolidated supervision by the Federal Reserve Board. The Final Rule thus excludes IHCs of foreign banking organizations under the Federal Reserve Board's Regulation YY, as they are subject to such consolidated supervision and to enhanced capital, liquidity, risk-management, and stress-testing requirements.[23]

(b) Additionally, the Final Rule clarified when the Commission will defer to a non-U.S. person's home country regulator in determining that the non-U.S. person is subject to sufficient non-U.S. regulation and is therefore excluded from the SRS definition. In particular, the Commission will defer to the foreign regulator where (a) the non-U.S. person is subject to capital standards and oversight consistent with Basel III and (b) the Commission has positively issued a CFTC Margin Determination with respect to uncleared swap margin requirements in the relevant jurisdiction.[24]

(c) For purposes of the SRS definition, the term "subsidiary" means "an affiliate of a person controlled by such person directly, or indirectly through one or more intermediaries."[25] The definition of "subsidiary" has been revised in the Final Rule for clarity by removing the definition of affiliate out of the definition of subsidiary and inserting it as a stand-alone definition in the Final Rule. Both the definition of subsidiary and the definition of affiliate remain substantially similar to the definitions given in Regulation S-X.

D. CONDUCTED THROUGH A U.S. BRANCH

The Commission proposed that the phrase "swap conducted through a U.S. branch" would mean a swap entered into by a U.S. branch where: (1) the U.S. branch is the office through which the non-U.S. person makes and receives payments and deliveries under the swap pursuant to a master netting or similar trading agreement, and the documentation of the swap specifies that the office for the non-U.S. person is such U.S. branch; or (2) the swap is reflected in the local accounts of the U.S. branch.[26]

In the Final Rule, the Commission removed the first prong of the definition such that the only relevant factor is whether the swap is reflected in the local accounts of the U.S. branch, meaning swaps for which the U.S. branch holds the risks and rewards, with the swap being accounted for as an obligation of the branch on the balance sheet of the U.S. branch under applicable accounting standards and under regulatory reporting requirements (i.e., the swap is "booked" in the U.S. branch).[27] This standard is intended to capture activity of non-U.S. banking organizations taking place in their U.S. branches that the CFTC believes should be treated as taking place in the United States.

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

Consistent with the Proposed Rule, the Final 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 is required to 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 Final Rule and consistent with the 2013 Guidance, a U.S. person would include all of its swap dealing transactions, including those with non-U.S. counterparties, in its de minimis threshold calculations without exception.[28]

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 Final Rule depends 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 Final Rule, a non-U.S. person applies 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.[29] Consistent with the position it took in the Proposed Rule and the 2013 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.

- **Swaps Subject to a Guarantee.** The Final Rule requires a non-U.S. person to include in its calculations for the purposes of the de minimis threshold calculation swap dealing transactions where its obligations under the swaps are subject to a guarantee by a U.S. person.[30] 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]

  Under the Final Rule, a non-U.S. person must also include in its de minimis threshold calculation swap dealing transactions where its counterparty is a Guaranteed Entity, except when:

  - (1) the Guaranteed Entity is registered as an SD; or
  - (2) the Guaranteed Entity's swaps are subject to a guarantee by a U.S. person that is a non-financial entity.[32]

  These 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]

  To maintain consistency with the Guidance, the Commission also adopted an exception that allows a non-U.S. person to exclude from its de minimis calculation swaps entered into with a Guaranteed Entity that is itself below the de minimis threshold and is affiliated with a registered SD.[34]

- **Swaps by and with a Significant Risk Subsidiary.** Under the Final Rule, an SRS must include all of its dealing swaps in its de minimis threshold calculation without exception. However, Other Non-U.S. Persons are not required to include a dealing swap with a non-U.S. SRS toward its de minimis threshold calculation, unless the SRS was also a Guaranteed Entity (and no exception applied).

The Commission's release includes a table summarizing the cross-border application of the SD de minimis threshold,[35] which is reproduced as Table 1 in Annex A below.

C. AGGREGATION REQUIREMENT

Under the Final Rule and consistent with the 2013 Guidance, a U.S. or non-U.S. person must 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.[36]

D. EXCHANGE-TRADED AND CLEARED SWAPS

Under the Final Rule, a non-U.S. person that is not a Guaranteed Entity or SRS is 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").[37]

III. ANE TRANSACTIONS

The ANE Staff Advisory provided that a non-U.S. SD would generally be required to comply with Transaction-Level Requirements (as that term was used in the Guidance) when entering into ANE Transactions.[38]

The Final Rule addresses certain of the Transaction-Level Requirements applicable to swap entities (specifically, the group B and group C requirements, described below), but does not cover other such requirements, such as the reporting, clearing, and trade execution requirements. The Commission noted its intention to address these remaining transaction-level requirements (the "Unaddressed TLRs") in connection with future cross-border rulemakings. Until such time, the Commission indicated that it will not consider, as a matter of policy, a non-U.S. swap entity's use of its personnel or agents located in the United States to "arrange, negotiate, or execute" swap transactions with non-U.S. counterparties for purposes of determining whether Unaddressed TLRs apply to such transactions.[39]

In connection with the Final Rule, DSIO withdrew Staff Advisory No. 13-69, and, together with the Division of Clearing and Risk and the Division of Market Oversight, granted certain non-U.S. swap dealers no-action relief with respect to the applicability of the Unaddressed TLRs to their transactions with non-U.S. counterparties that are arranged, negotiated, or executed in the United States.[40]

IV. 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 Final Rule includes certain exceptions from, and a substituted compliance process for, cross-border regulation of registered SDs. The Final Rule also creates a framework for comparability determinations that, according to the Commission, "emphasizes a holistic, outcomes-based approach."[41]

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

The 2013 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 Final Rule instead classifies 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, as adopted in the Final Rule:

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 Section 45.2(a) – Swap Recordkeeping (to the extent it duplicates 23.201)	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 Final 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 are 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, are subject to the group A requirements under the Final Rule.[42] 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.[43] 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.[44]

With respect to the group A requirements, in the Final Rule, the Commission added § 45.2(a) to the extent it duplicates § 23.201's requirement that each swap entity keep full records of activities related to its business as a swap entity.[45] The Commission made the addition to clarify that, to the extent the same substantive recordkeeping requirement is included in both §§ 23.201 and 45.2(a), each is a group A requirement for which substituted compliance may be available. Similarly, the Commission indicated that it will view any previously issued comparability determination that allows substituted compliance for § 23.201 to also allow for substituted compliance with § 45.2(a) to the extent it duplicates § 23.201.[46]

With respect to the group C requirements, the Final Rule adds the requirements of part 23, Subpart L, pertaining to elective initial margin segregation, to the list of group C requirements. The Commission noted that these requirements are largely focused on consumer protection rather than risk mitigation.[47]

The category of group B requirements was adopted as proposed.

B. EXCEPTIONS

The Commission adopted four exceptions from certain Commission regulations which would be available only to "foreign-based swaps." The Final Rule defines a foreign-based swap 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 of a U.S. bank.[48] The first exception the Commission adopted is an exception from certain group B and C requirements for certain anonymous, exchange-traded, and cleared foreign-based swaps (the "Exchange-Traded Exception"). Second, the Commission adopted an exception from the group C requirements for certain foreign-based swaps with foreign counterparties (the "Foreign Swap Group C Exception").[49] Third, the Commission adopted, with certain modifications, an exception from the group B requirements for the foreign-based swaps of certain non-U.S. swap entities with certain foreign counterparties (the "Non-U.S. Swap Entity Group B Exception"). Fourth, the Commission adopted 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 (the "Foreign Branch Group B Exception"). The Commission notes, however, that

notwithstanding these exceptions, swap entities would remain subject to certain provisions of the CEA and Commission regulations, including the prohibition on manipulative or deceptive devices found in § 180.1 of the Commission's regulations.[50]

1. Exchange-Traded Exception

The Commission proposed that, with respect to its foreign-based swaps, each non-U.S. swap entity and foreign branch of a U.S. swap entity would be excepted from the group B requirements (other than the daily trading records requirements in §§ 23.202(a) through 23.202(a)(1)). It also proposed that those entities be excepted from the group C requirements with respect to any swap entered into on a DCM, a registered SEF or an SEF exempted from registration by the Commission pursuant to section 5h(g) of the CEA, or an FBOT registered with the Commission pursuant to part 48 of its regulations where, in each case, the swap is cleared through a registered DCO or a clearing organization that has been exempted from registration by the Commission pursuant to section 5b(h) of the CEA, and the swap entity does not know the identity of the counterparty to the swap prior to execution. The Commission adopted the exception as proposed.[51]

2. Foreign Swap Group C Exception and U.S. Branch Group C Exception

In the Proposed Rule, the Commission proposed that each non-U.S. swap entity and foreign branch of a U.S. swap entity would be excepted from the group C requirements with respect to any foreign-based swap with a foreign counterparty.[52] The Commission adopted the exception as proposed. The Commission noted that, although the exception is being adopted as proposed, the scope of the exception is effectively being expanded because the Subpart L requirements have been added to the group C requirements under the Final Rule. In addition, based on the comments received, the Commission is adopting an additional exception from the group C requirements for certain swaps of U.S. branches of non-U.S. swap entities ("U.S. Branch Group C Exception"). Specifically, under the U.S. Branch Group C Exception, a non-U.S. swap entity is excepted from the group C requirements with respect to any swap booked in a U.S. branch with a foreign counterparty that is neither a foreign branch of a U.S. entity nor a Guaranteed Entity. The Commission is adopting this exception because, although the swaps benefiting from the exception are part of the U.S. swap market, the Commission believes that foreign regulators have a stronger interest in such swaps with respect to the group C requirements — which relate to counterparty protection rather than risk mitigation — because they are between a non-U.S. swap entity (by definition, a non-U.S. person) and certain foreign counterparties that have a limited nexus to the United States (i.e., non-U.S. persons, including SRSs that are not Guaranteed Entities).[53]

3. Limited 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).[54] The Commission adopted the exception with certain modifications. Specifically, the Commission: (1) narrowed the exception such that it is not available for swaps between swap entities; (2) broadened the exception to apply to foreign-based swaps with SRSs that are neither swap entities nor Guaranteed Entities ("SRS End User"); and (3) made some minor technical changes to the text of the Final Rule.

The Commission notes that a swap between the foreign branch of a U.S. swap entity and a non-U.S. swap entity should generally be subject to the group B requirements. Where both parties to a swap are registered swap entities, the Commission notes that there should be no impediment to compliance with the group B requirements.[55] With respect to SRS End Users, the Commission acknowledges that applying the group B requirements to a swap entity's swaps indirectly affects their counterparties, including SRS End User counterparties, by requiring them to execute documentation (e.g., compliant swap trading relationship documentation), and engage in portfolio reconciliation and compression exercises as a condition to entering into swaps with swap entity counterparties. Considering this and the Commission's belief that it is important to ensure that an SRS, particularly a commercial or non-financial entity, continues to have access to swap liquidity for hedging or other non-dealing purposes, the Commission expanded the exception only to SRS End Users (and not to SRSs that are swap entities or Guaranteed Entities).[56]

In addition, in response to commenters requesting further guidance on the application of the exception, the Commission clarified that the five percent gross notional amount cap applies only to swaps entered into in reliance on the exception. This does not include situations where a foreign branch of a U.S. swap entity complies with all of the group B requirements, either directly or through substituted compliance, with respect to a swap that is eligible for the exception.[57]

4. 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.[58] The Commission adopted this rule with certain modifications. Specifically, for the same reasons that the Commission expanded the Limited Foreign Branch Group B Exception to include swaps with SRS End Users, the Commission also expanded the Non-U.S. Swap Entity Group B Exception to include swaps with SRS End Users.

The Commission's release includes tables summarizing the cross-border application of the group B and group C requirements in consideration of these exceptions,[59] which are reproduced as Table 2 (group B requirements) and Table 3 (group C requirements) in Annex A below.

C. SUBSTITUTED COMPLIANCE

The Commission adopted an approach to substituted compliance largely as proposed. The Commission proposed to permit a non-U.S. swap entity to avail itself of substituted compliance with respect to the group A requirements on an entity-wide basis.[60] The Commission also proposed to permit a non-U.S. swap entity or a foreign branch of a U.S. swap entity to avail itself of substituted compliance with respect to the group B requirements for its foreign-based swaps with foreign counterparties.[61] The Commission did not propose to permit substituted compliance for the group C requirements, from which broader exceptions for swaps with foreign counterparties would be available.

The Commission noted that the group A requirements—which relate to compliance programs, risk management, and swap data recordkeeping—cannot be effectively applied on a fragmented jurisdictional basis. Accordingly, the CFTC believes that it is not practical to limit substituted compliance for the group A requirements to only those transactions involving non-U.S. persons. Thus, in furtherance of international comity, the Final Rule permits a non-U.S. swap entity, subject to the terms of the relevant comparability determination, to satisfy any applicable group A requirement on an entity-wide basis by complying with the applicable standards of a foreign jurisdiction.[62]

Unlike the group A requirements, the group B requirements—which relate to counterparty relationship documentation, portfolio reconciliation and compression, trade confirmation, and daily trading records—are more closely tied to local market conventions and can be effectively implemented on a transaction-by-transaction or relationship basis. As noted above, the Commission believes that Congress intended for the Dodd-Frank Act to apply fully to U.S. persons (other than their foreign branches) with no substituted compliance available. By this logic, the Commission determined that an expansion of substituted compliance for the group B requirements for U.S. persons is not appropriate. Accordingly, subject to the terms of the relevant comparability determination, the Final Rule permits a non-U.S. swap entity or foreign branch of a U.S. swap entity to avail itself of substituted compliance for the group B requirements in certain circumstances, depending on the nature of its counterparty.

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

D. COMPARABILITY DETERMINATIONS

The Final Rule adopts a process pursuant to which the CFTC will conduct comparability determinations using "a flexible outcomes-based approach that emphasizes comparable regulatory outcomes over identical regulatory approaches." The proposed approach is similar to the approach adopted in the Proposed Rule, the 2013 Guidance and the Cross-Border Margin Rule, and previously issued comparability determinations will remain valid under the Final Rule.[63]

In the Final Rule, the Commission emphasized the need for a flexible outcomes-based approach rather than focusing on identical regulatory approaches. Specifically, the Commission proposed a standard of review that was designed to allow the Commission to consider all relevant elements of a foreign jurisdiction's regulatory regime, thereby permitting the Commission to tailor its assessment to a broad range of foreign regulatory approaches.[64] Accordingly, pursuant to the Proposed Rule, a foreign jurisdiction's regulatory regime did not need to be identical to the relevant Commission requirements, so long as both regulatory frameworks are comparable in terms of holistic outcome. The Proposed Rule permitted the Commission to consider any factor it deems appropriate when assessing comparability. The Commission adopted the standard of review as proposed with certain modifications. Specifically, the Commission made some technical changes to the standard of review to clarify, as stated in the Proposed Rule, that the Commission may issue a comparability determination based on its determination that some or all of the relevant foreign jurisdiction's standards would result in outcomes comparable to those of the Commission's corresponding requirements or group of requirements.

Pursuant to the Final Rule, the Commission may consider any factor it deems appropriate in assessing comparability, which may include: (1) the scope and objectives of the relevant foreign jurisdiction's regulatory standards; (2) whether, despite differences, a foreign jurisdiction's regulatory standards achieve comparable regulatory outcomes to the Commission's corresponding requirements; (3) the ability of the relevant regulatory authority or authorities to supervise and enforce compliance with the relevant foreign jurisdiction's regulatory standards; and (4) whether the relevant foreign jurisdiction's regulatory authorities have entered into a memorandum of understanding or similar cooperative arrangement with the Commission regarding the oversight of swap entities.[65] In assessing comparability, the Commission need not find that a foreign jurisdiction has a comparable regulatory standard that corresponds to each group A or group B requirement.

V. RECORDKEEPING

Under the Final Rule, an SD is required to create a record of its compliance with all provisions of the Final Rule, and retain those records in accordance with § 23.203. The Commission adopted this provision as proposed.

* * *

ENDNOTES

1 7 U.S.C. § 2(i).

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

3 *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.

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

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

6 CFTC Staff Letter Nos. 14-01, 14-74, 14-140, 15-48, 16-64, and 17-36. The Commission ended this no-action relief on July 23, 2020, after passing the Final Rule. CFTC Letter No. 20-21.

7 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).

8 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).

9 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.

10 Proposed Rule, 85 FR 952. For a discussion of the requirements of the Proposed Rule, please see our client memorandum *CFTC Proposes Cross-Border Swaps Rule*, dated January 16, 2020, *available at* https://www.sullcrom.com/files/upload/SC-Publication-CFTC-Proposes-Cross-Border-Swaps-Rule.pdf.

11 *See* Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 FR 56924 (Sept. 14, 2020), *available at* https://www.cftc.gov/sites/default/files/2020/09/2020-16489a.pdf.

12 *See* 17 C.F.R. § 23.23(a).

13 Final Rule, 85 FR at 56932; 17 C.F.R. § 23.23(a). To provide certainty to market participants, the Commission proposed to permit reliance, until December 31, 2025, on any U.S. person-related representations that were obtained pursuant to the Proposed Rule or the 2013 Guidance. In response to industry comments, the Commission is adopting an approximately seven-year time limit, until December 31, 2027, for reliance on "U.S. Person" and "guarantee" representations, rather than the five-year limit that was proposed. Final Rule, 85 FR at 56941; 17 C.F.R. §§ 23.23(a)(9) and (a)(23)(iv). The Commission further clarified that reliance on representations obtained pursuant to the prior regimes is only permitted if those representations were made prior to the effective date of the Final Rule. Swap entities may only rely representations obtained on or after November 13, 2020, if they are made pursuant to the Final Rule. Final Rule, 85 FR at 56941.

14 Final Rule, 85 FR at 56933.

15 17 C.F.R. § 23.23(a)(23)(i)(B).

16 *Id*. at § 23.23(a)(23)(ii).

17 Final Rule, 85 FR at 56933.

18 Final Rule, 85 FR at 56935.

19 17 C.F.R. § 23.23(a)(9).

ENDNOTES (CONTINUED)

[20] Final Rule, 85 FR at 56940.

[21] The Final Rule's SRS scheme essentially replaces the affiliate conduit scheme employed by the 2013 Guidance. Both schemes were designed to prevent banks from evading Dodd-Frank's requirements for U.S. entities meant to lessen risk within the United States by simply using foreign affiliates. *See* Final Rule, 85 FR at 57013.

[22] An entity is a "significant subsidiary" of its ultimate U.S. parent when, on a three-year rolling average basis, (a) its equity capital is equal to or greater than five percent of its ultimate parent's consolidated equity capital, (b) its total revenue is equal to or greater than its ultimate parent's total consolidated revenue, or (c) its total assets are equal to or greater than ten percent of its ultimate U.S. parent's total consolidated assets. 17 C.F.R. § 23.23(a)(14).

[23] Final Rule, 85 FR at 56943; 17 C.F.R. § 23.23(a)(13)(i).

[24] Final Rule, 85 FR at 56946; 17 C.F.R. § 23.23(a)(13)(ii).

[25] 17 C.F.R. § 23.23(a)(15); Final Rule, 85 FR at 56943.

[26] Final Rule, 85 FR at 56949.

[27] *See* 17 C.F.R. § 23.23(a)(16).

[28] *Id.* at 23.23(b)(1); Final Rule, 85 FR at 56951.

[29] *Id.* at 23.23(b)(2)(i).

[30] *Id.* at 23.23(b)(2)(ii).

[31] Final Rule, 85 FR at 56953; Proposed Rule, 85 FR at 972.

[32] 17 C.F.R. § 23.23(b)(2)(iii).

[33] Final Rule, 85 FR at 56954; Proposed Rule, 85 FR at 972.

[34] *See* 17 C.F.R. § 23.23(b)(2)(iii)(C).

[35] Final Rule, 85 FR at 56994.

[36] Final Rule, 85 FR at 56955; Proposed Rule, 85 FR at 972-973.

[37] Final Rule, 85 FR at 56955-56.

[38] CFTC Staff Advisory No. 13-69, Applicability of Transaction-Level Requirements to Activity in the United States (Nov. 14, 2013). Transaction-Level Requirements include: "(1) Required clearing and swap processing; (2) margin (and segregation) for uncleared swaps; (3) mandatory trade execution; (4) swap trading relationship documentation; (5) portfolio reconciliation and compression; (6) real-time public reporting; (7) trade confirmation; (8) daily trading records; and (9) external business conduct standards." Final Rule, 85 FR at 56964.

[39] Final Rule, 85 FR at 56963.

[40] *Id*.

[41] *Id*.

[42] Final Rule, 85 FR at 56964.

[43] Final Rule, 85 FR at 56966.

[44] Final Rule, 85 FR at 56967.

[45] *See* Final Rule, 85 FR at 56965.

[46] Final Rule, 85 FR at 56965-66.

[47] Final Rule, 85 FR at 56967-68.

ENDNOTES (CONTINUED)

48 17 C.F.R. § 23.23(a)(4).

49 As adopted, "foreign counterparty" means "(i) A non-U.S. person, except with respect to a swap booked in a U.S. branch of that non-U.S. person; or (ii) A foreign branch where it enters into a swap in a manner that satisfies the definition of a swap conducted through a foreign branch." 17 C.F.R. § 23.23(a)(5); Final Rule, 85 FR at 56997.

50 17 C.F.R. § 180.1.

51 The Commission noted that the addition of the Subpart L requirements to the group C requirements under the Final Rule will not substantively expand the Exchange-Traded Exception, as the Subpart L requirements do not apply to swaps cleared by a DCO. Also, as stated in the Proposed Rule, the Commission noted that it considers the exception also to apply with respect to an FBOT that provides direct access to its order entry and trade-matching system from within the U.S. pursuant to no-action relief issued by Commission staff.

52 Proposed Rule, 85 FR at 983-84.

53 Final Rule, 85 FR at 56971-72.

54 Proposed Rule, 85 FR at 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.

55 Final Rule, 85 FR at 56973.

56 Final Rule, 85 FR at 56973-74.

57 Final Rule, 85 FR at 56974.

58 Proposed Rule, 85 FR at 984.

59 Final Rule, 85 FR at 56995-97.

60 Proposed Rule, 85 FR at 985.

61 *Id*.

62 Final Rule, 85 FR at 56977.

63 *Id*.

64 Proposed Rule, 85 FR at 986-87.

65 Final Rule, 85 FR at 56978.

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ANNEX A: INDICATIVE CHARTS

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

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

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

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

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

[2] Under the Final Rule, the Foreign Branch Group B Exception is available from the Group B requirements for a foreign branch's foreign-based swaps with a foreign counterparty that is an 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	SRS	Other Non-U.S. Persons
U.S. Swap Entity	Non-Foreign Branch	Yes	Yes	Yes	Yes	Yes	Yes
	Foreign Branch	Yes[1]	No	Yes[1]	No	No	No
Non-U.S. Swap Entity	U.S. Branch	Yes	Yes	Yes	Yes	No	No
	Guaranteed Entity or SRS	Yes[1]	No	Yes[1]	No	No	No
	Other Non-U.S. Persons	Yes[1]	No	Yes[1]	No	No	No

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