

September 7, 2018

CFTC Chairman Previews New Approach to Cross-Border Application of Dodd-Frank Swaps Provisions, Exemptions

Forthcoming White Paper to Propose New Approach to Providing Exemptions and Other Relief for Certain Non-U.S. Clearinghouses, Trading Venues, and Swap Dealing Businesses

SUMMARY

Speaking at a City of London event on September 4, 2018, U.S. Commodity Futures Trading Commission (the “CFTC”) Chairman Christopher Giancarlo discussed the “current state of swaps reform” and outlined an “updated and improved vision for cross-border swaps regulation.” The Chairman’s speech characterized the CFTC’s current approach to rulemaking with regard to the cross-border application of the swaps provisions of Title VII of the Dodd-Frank Act as “over-expansive, unduly complex, and operationally impractical.” Chairman Giancarlo announced that “in the near future” he would release a white paper that “recognize[s] deficiencies in the CFTC’s current approach to regulating cross-border activities and seek[s] to recalibrate the CFTC’s cross-border approach based on a set of guiding principles.” The Chairman also plans to direct the CFTC staff to develop proposed rules governing the cross-border application of the Dodd-Frank swaps provisions by focusing on, among other principles, “act[ing] with deference toward comparable swaps reform regulation in non-U.S. markets by adopting a flexible, outcomes-based approach for substituted compliance.” The speech stressed that the focus should be on “whether a non-U.S. regulator’s regime, in the aggregate, provides a sufficient level of regulation to justify a comparability assessment,” and specific recommendations that were previewed included the possibility of broader exemptive or other relief for certain non-U.S. central counterparties, swap trading venues, and swap dealing businesses.

COMMENTS ON EXISTING CFTC APPROACH TO CROSS-BORDER APPLICATION OF THE DODD-FRANK SWAPS PROVISIONS

In the speech,¹ Chairman Giancarlo acknowledged that the U.S. had been among the earliest jurisdictions in implementing the over-the-counter swaps regulatory reforms agreed to by the G20 (e.g., trade reporting, central clearing, margin requirements for uncleared swaps, and capital requirements for uncleared swaps). However, he observed that many other jurisdictions have now also made substantial progress, and that this has made the CFTC's early approach to the cross-border application of the swaps rules "out of step with the world's major swaps trading regimes that have now adopted comparable swaps reforms." From that perspective, the speech identified the following problems with respect to CFTC's current approach to the cross-border application² of the Dodd-Frank swaps provisions:

- It is expressed in Commission "guidance," rather than formal Commission regulation.
- It is over-expansive, unduly complex, and operationally impractical.
- It is premised on the incorrect assumption that every single swap a U.S. person enters into, no matter where and how transacted, has a direct and significant connection with activities in, and effect on, commerce of the United States that requires imposing the imposition of CFTC transaction rules.
- It is conceptually inconsistent in utilizing a "U.S. entity" test for swaps activity abroad and a "territorial" test for swaps activity in the United States.
- It relies on a substituted compliance regime that applies a somewhat arbitrary, rule-by-rule comparison of CFTC and non-U.S. rules under which a transaction or entity may be subject to a patchwork of U.S. and non-U.S. regulation.
- It shows insufficient deference to non-U.S. regulators that have adopted comparable swaps reforms for their jurisdictions, which is inconsistent with the CFTC's traditional approach of comity to competent overseas regulation.
- It fails to distinguish between those swaps reforms that are designed to mitigate cross-border systemic risk and those reforms that address particular market and trading practices that are suitable for tailoring to local trading conditions.
- It has driven global market participants away from transacting with entities subject to CFTC swaps regulation and caused fragmentation of what were once global markets into a series of separate liquidity pools that are less resilient to market shocks, thereby increasing systemic risk rather than diminishing it.

After identifying and discussing the problems outlined above, Chairman Giancarlo focused the majority of the remainder of the speech on outlining a series of going forward principles to guide the cross-border application of the swaps rules:

- The CFTC should recognize the distinction between swaps reforms intended to mitigate cross-border systemic risk and reforms designed to address particular market and trading practices that are suitable for tailoring to jurisdictional trading conditions.
- The CFTC should pursue multilateralism, not unilateralism, for swaps reforms that are designed to mitigate systemic risk.

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- The CFTC shall be a “rule maker,” not a “rule taker,” in overseeing U.S. markets: one marketplace, one set of trading rules.
- The CFTC should act with deference towards comparable swaps reform regulation in non-U.S. markets by adopting a flexible, outcomes-based approach for substituted compliance.
- The CFTC should act to encourage adoption of comparable swaps reform regulation in non-U.S. markets that have not yet adopted swaps reform for any significant swaps trading activity.

SPECIFIC RECOMMENDATIONS

The speech concluded by addressing specific issues related to non-U.S. central counterparties, non-U.S. trading venues, and non-U.S. swap dealers, and by previewing specific rule-making recommendations for each of these areas that would be discussed in greater detail in a forthcoming white paper.

Non-U.S. Central Counterparties

The speech suggested that the Commission should expand its use of exemptive authority for non-U.S. central counterparties (or “CCPs”) that clear swaps on behalf of U.S. persons and do not pose substantial risk to the U.S. financial system, if the CCP is subject to “comparable, comprehensive supervision and regulation” in its home jurisdiction. The speech clarified, however, that non-U.S. CCPs that clear swaps for U.S. persons and are deemed by the Commission to “pose substantial risk to the U.S. financial system” would “continue to be required to register with, and then be regulated by, the CFTC, with a focus on their U.S.-facing business.”

Non-U.S. Trading Venues

Addressing non-U.S. trading venues, Chairman Giancarlo argued in the speech that the CFTC should exempt non-U.S. trading venues subject to comparable regulation from registration as swap execution facilities with respect to all types of swaps, including both swaps that are subject to the CFTC’s trade execution requirement (*i.e.*, required transactions) and swaps that are not (*i.e.*, permitted transactions).

Speaking to both the CCP and trading venue recommendations, Chairman Giancarlo noted that 2016 CFTC – European Commission (EC) Agreement establishing a common approach to regulating transatlantic CCPs and the 2017 CFTC-EC Agreement for derivatives trading venues would stay in place with the EU. He indicated that a similar approach would be taken to other jurisdictions with comparable regulatory requirements for swaps CCPs and trading venues.

Non-U.S. Swap Dealers

Addressing the CFTC’s registration and other regulatory requirements applicable to swap dealers, Chairman Giancarlo argued that the CFTC should “take an approach to registration for non-U.S. swap dealers that both recognizes risk-mitigating measures and shows appropriate deference to non-U.S. regulatory regimes that have comparable requirements for entities engaged in swap dealing activity.” Making specific recommendations, he suggested that non-U.S. persons should not have to count toward

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their swap dealer *de minimis* threshold (*i.e.*, the notional level of swap dealing activity, as measured on a rolling 12-month basis, below which registration is not required) either of (1) swaps with other non-U.S. persons that are registered as swap dealers, or (2) swaps with foreign consolidated subsidiaries (generally, non-U.S. persons that are consolidated for accounting purposes with an ultimate parent entity that is a U.S. person).

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Although the Chairman did not give a specific timetable for release of the white paper, we expect that it will be published in the near term and that it will address many of the points raised in the Chairman's speech.

ENDNOTES

- ¹ *Remarks of Chairman J. Christopher Giancarlo to the City Guildhall*, London, United Kingdom Sept. 4, 2018), available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo52>.
- ² Section 2(i) of the Commodity Exchange Act ("CEA"), as amended by Dodd-Frank, provides that: "The provisions of [the CEA] relating to swaps that were enacted by [Dodd-Frank] (including any rule prescribed or regulation promulgated under [Dodd-Frank]), shall not apply to activities outside the United States unless those activities—(1) have a direct and significant connection with activities in, or effect on, commerce of the United States; or (2) contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of this chapter that was enacted by [Dodd-Frank]."

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CONTACTS

New York

Whitney A. Chatterjee	+1-212-558-4883	chatterjee@sullcrom.com
David J. Gilberg	+1-212-558-4680	gilbergd@sullcrom.com
Kenneth M. Raisler	+1-212-558-4675	raislerk@sullcrom.com
Rebecca J. Simmons	+1-212-558-3175	simmonsr@sullcrom.com
William D. Torchiana	+1-212-558-4056	torchianaw@sullcrom.com
Christine Trent Parker	+1-212-558-3631	parkerct@sullcrom.com
Ryne V. Miller	+1-212-558-3268	millery@sullcrom.com
Daniel M. Wolf	+1-212-558-4815	wolfd@sullcrom.com

Washington, D.C.

Eric J. Kadel, Jr.	+1-202-956-7640	kadelej@sullcrom.com
Samuel R. Woodall III	+1-202-956-7584	woodalls@sullcrom.com

Australia

Robert Chu	+61-3-9635-1506	chur@sullcrom.com
Waldo D. Jones Jr.	+61-2-8227-6702	jonesw@sullcrom.com

Beijing

Gwen Wong	+86-10-5923-5967	wonggw@sullcrom.com
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Frankfurt

Krystian Czerniecki	+49-69-4272-5525	czernieckik@sullcrom.com
Wolfgang Feuring	+49-69-4272-5511	feuringw@sullcrom.com

Hong Kong

Michael G. DeSombre	+852-2826-8696	desombrem@sullcrom.com
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SULLIVAN & CROMWELL LLP

London

Vanessa K. Blackmore	+44-20-7959-8480	blackmorev@sullcrom.com
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Paris

William D. Torchiana	+33-1-7304-5890	torchianaw@sullcrom.com
----------------------	-----------------	--

Tokyo

Izumi Akai	+81-3-3213-6145	akaii@sullcrom.com
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