Cross-Border Security-Based Swaps


EXECUTIVE SUMMARY

On May 1, 2013, the Securities and Exchange Commission issued a release proposing rules and guidance on the cross-border application of certain security-based swap provisions under the Securities Exchange Act of 1934. The proposing release was subsequently published in the Federal Register on May 23 and reflects the SEC’s attempt to address cross-border security-based swap activities “holistically” in a single proposing release.

Among other things, the proposing release addresses:

- the key definitions of “U.S. person” and “transaction conducted within the United States” to be used to establish the scope of the proposed cross-border security-based swap regime;
- the application of the proposed cross-border regime to foreign branches, affiliates and subsidiaries of U.S. and non-U.S. persons, and the proposed impact of guarantees in the cross-border context;
- the proposed impact of cross-border security-based swap transactions on the registration obligations of security-based swap dealers and major security-based swap participants;
- the proposed aggregation rules to be used in determining security-based swap dealer status generally (and not just in the cross-border context);
- entity-level and transaction-level requirements that would apply to security-based swap market participants engaged in cross-border security-based swap transactions;
- the proposed reporting and public dissemination obligations with respect to cross-border security-based swap transactions;
- the proposed mandatory clearing and trade execution requirements with respect to cross-border security-based swap transactions; and
- the impact of the proposed cross-border security-based swap regime on clearing agencies, execution facilities and swap data repositories.
The proposing release also proposes a policy framework for “substituted compliance” under which security-based swap market participants and infrastructure providers may satisfy their obligations under certain provisions of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act and related rules by complying with comparable non-U.S. regulatory regimes.

The SEC’s approach in the proposing release differs in certain respects from the approach taken by the Commodity Futures Trading Commission in its analogous release proposing a framework for regulation of cross-border swaps, swap markets, and swap market participants.

Public comments on the proposing release are due by August 21, 2013.

Separately, on May 1, 2013, the SEC also voted to reopen, until July 22, 2013, the comment period for all rules relating to Title VII of Dodd-Frank that are not yet final. This comment period also applies to the related SEC policy statement describing the order in which these rules are expected to become effective.
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I. BACKGROUND

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") gives the Securities and Exchange Commission (the “SEC”) and the Commodity Futures Trading Commission (the “CFTC”) extensive authority to regulate over-the-counter derivative products, markets and market participants. Under Title VII of Dodd-Frank ("Title VII"), the SEC has authority over security-based swap ("SBS") transactions and participants in the SBS market and the CFTC has authority over swap transactions, swap markets and swap market participants.

Among other matters, the Title VII regime requires security-based swap dealers ("SBSDs") and major security-based swap participants ("MSBSPs") to register with the SEC and comply with an extensive regulatory framework.

Dodd-Frank also limits the extraterritorial reach of the agencies’ regulatory authority. In the case of the SEC, Section 772(b) of Dodd-Frank added Section 30(c) to the Securities Exchange Act of 1934 (the “Exchange Act”), which provides that “[n]o provision of [the Exchange Act that was added by Title VII] . . . shall apply to any person insofar as such person transacts a business in security-based swaps without the jurisdiction of the United States, unless such person transacts such business in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate to prevent the evasion of any provision of [the Exchange Act that was added by Title VII].”

On May 1, 2013, the SEC issued a release proposing rules and guidance on the cross-border application of certain SBS provisions under the Exchange Act (the “Proposing Release”). The Proposing Release reflects the SEC’s position that Section 30(c) of the Exchange Act does not require the SEC to find actual evasion in order to invoke its authority to reach activity “without the jurisdiction of the United States.” Rather, the SEC believes that Section 30(c) permits it to impose “prophylactic rules intended to prevent possible evasion, even if they affect both evasive and non-evasive conduct,” and “even if those rules would also apply to a market participant that has been transacting business through a pre-existing market structure such as a foreign branch or guaranteed foreign affiliate established for valid business purposes, provided the proposed rule or interpretation is designed to prevent possible evasive conduct.”

The SEC’s approach differs in certain respects from the approach taken by the CFTC in its analogous release proposing a framework for regulation of cross-border swaps, swap markets and swap market participants.¹

The extent of the SEC’s proposed cross-border application of Title VII has generated extensive comments from U.S. and non-U.S. market participants, foreign regulatory authorities and others. Commenters have raised particular concerns regarding the possibility of required compliance with duplicative or conflicting regulatory regimes. In the Proposing Release, the SEC seeks to respond to

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¹ For more information, see 15 U.S.C. § 78u-5(d).
these concerns by proposing to permit “substituted compliance” by some non-U.S. regulated entities with comparable foreign requirements in satisfaction of the requirements that would apply domestically.

II. TERRITORIAL APPLICATION OF TITLE VII TO CROSS-BORDER SBS TRANSACTIONS

Generally, the requirements of the Exchange Act that were added by Title VII would apply to SBS transactions where at least one of the counterparties is a “U.S. person” or that are “transactions conducted within the United States,” as those terms are defined in the Proposed Rules. Accordingly, we begin with a discussion of those key terms as they are defined in the SEC’s proposed cross-border rules included in the Proposing Release (the “Proposed Rules”).

A. “U.S. PERSON”

The Proposed Rules define a “U.S. person” as:

- any natural person resident in the United States;
- any partnership, corporation, trust, or other legal person organized or incorporated under the laws of the United States or having its principal place of business in the United States; or
- any account (whether discretionary or non-discretionary) of a U.S. person.°

1. Natural Persons

Individuals resident abroad would not be treated as U.S. persons, even if they possess U.S. citizenship.

2. Foreign Branches of U.S. Entities

The “U.S. person” definition in the Proposed Rules focuses on the status of the particular legal person, and includes all branches and offices of that person. As discussed below, however, certain activities of a foreign branch of a U.S. bank (a “Foreign Branch”), and certain activities of market participants with or through a Foreign Branch, may be treated like activities of non-U.S. persons.

To qualify as a Foreign Branch under the Proposed Rules, the branch of a U.S. bank must be:

- located outside the United States;
- operated for valid business reasons;
- engaged in the business of banking; and
- subject to substantive banking regulation in the jurisdiction where located.

Foreign agencies of U.S. banks would receive no special treatment under the Proposed Rules. This approach stands in contrast to the definition of U.S. person in Regulation S under the Securities Act of 1933, where branches and agencies are treated identically. In justifying the proposed approach, the SEC notes that although the Regulation S definition is familiar to a number of market participants, Regulation S focuses on the person making investment decisions while Title VII focuses on the person actually bearing
the risk of those decisions. The SEC invites comments regarding its exclusion of agencies from the
Foreign Branch definition in the Proposed Rules.

3. Non-U.S. Subsidiaries and Other Affiliates of U.S. Persons
Under the Proposed Rules, whether an entity is a U.S. person would be determined at the entity level,
without regard to the status of affiliates of the entity that are separate legal persons. Thus, a non-U.S.
subsidiary of a U.S. person would be a non-U.S. person, even if the non-U.S. subsidiary’s obligations are
guaranteed by its U.S. parent. In addition, the establishment or maintenance by a non-U.S. parent entity
of a U.S. subsidiary would not affect the U.S. person status of the non-U.S. corporate parent or its other
affiliates.

4. Certain International Organizations
Certain international organizations, including the IMF, the World Bank, the Inter-American Development
Bank, the Asian Development Bank, the African Development Bank, the United Nations and “any other
similar organizations,” as well as their respective agencies and pension plans, would be excluded from
the definition of U.S. person under the Proposed Rules. This exclusion would not apply, however, to
other affiliates of these organizations, who would have to separately consider their status as U.S. persons.

Guidance in the Proposing Release expresses the SEC’s belief that “most of [the] membership and
financial activity [of these organizations] are outside the United States,” and indicates that their exclusion
from the U.S. person definition is “based on the nature of these entities as international organizations.”
However, the Proposing Release provides no additional guidance regarding the specific characteristics
that non-enumerated “similar organizations” must exhibit in order to qualify for the exclusion. ³

5. Accounts of U.S. Persons
Guidance in the Proposing Release indicates that the U.S. person status of any account should turn on
whether any owner of the account is itself a U.S. person. ⁴ The location of the account, the status of the
fiduciary or other person managing the account, the discretionary or non-discretionary nature of the
account, or the status of the entity at which it is held or maintained, would not be determinative.

Conversely, the Proposing Release indicates that accounts of non-U.S. persons would not be U.S.
persons solely because they are held by a U.S. financial institution or other entity that is a U.S. person.
This aspect of the U.S. person definition differs from Regulation S, under which discretionary (but not
non-discretionary) accounts held by a dealer or other fiduciary organized, incorporated or resident in the
United States are U.S. persons, regardless of the identity of the account owner.

6. Differences with the CFTC’s Approach
The SEC’s proposed definition of “U.S. person” differs in certain respects from the CFTC’s proposed
definition of the same term. For example, the CFTC would define “U.S. person” to specifically include (i)
any estate or trust, the income of which is subject to U.S. income tax (even if the estate or trust itself were
not formed under U.S. laws), (ii) any pension plan for the employees, officers or principals of any legal entity with its principal place of business within the United States and (iii) a commodity pool, pooled account or collective investment vehicle, wherever organized, in which a majority ownership is held, directly or indirectly, by U.S. persons or whose operator is required to register as a commodity pool operator under the Commodity Exchange Act. In addition, the CFTC would extend the definition of “U.S. person” to include any entity directly or indirectly majority-owned by U.S. persons with unlimited liability for the entity’s obligations.\(^5\)

B. “TRANSACTION CONDUCTED WITHIN THE UNITED STATES”

The Proposed Rules would consider an SBS transaction to be a “transaction conducted within the United States” if the transaction is “solicited, negotiated, executed, or booked within the United States by or on behalf of either counterparty to the transaction, regardless of the location, domicile, or residence status of either counterparty to the transaction,” subject to the Foreign Branch exception discussed below.\(^6\) Under this definition, any person located within the United States and engaged in any of the solicitation, negotiation or execution of an SBS transaction would be subject to the SEC’s Title VII regime, even if the transaction is booked through a non-U.S.-based entity.

The Proposed Rules would permit a person to rely on a counterparty’s representation that the relevant “transaction is not solicited, negotiated, executed or booked within the United States by or on behalf of” that counterparty, absent actual knowledge of the person to the contrary.

1. Direct and Indirect Counterparties; Guarantees

In defining when a transaction is “conducted within the United States,” the Proposing Release provides that the term “counterparty” is intended to refer to direct counterparties to an SBS transaction, and does not cover “indirect counterparties,” i.e., guarantors that guarantee the performance of direct counterparties under the SBS transaction. Accordingly, an SBS transaction would not be a “transaction conducted within the United States” solely because a related guarantee was solicited, negotiated, executed or booked within the United States.

2. Activities that Render an SBS Transaction “Conducted Within the United States”

For purposes of determining whether a potential SBSD’s SBS dealing activity counts against the \textit{de minimis} amount, which is discussed further in Section III.A below, the Proposing Release states that “engaging in any of [the solicitation, negotiation, execution or booking of an SBS transaction] within the United States, as part of dealing activity, would involve a level of involvement that the [SEC] believes should require such transaction to count toward a potential SBSD’s \textit{de minimis} amount.”\(^7\) The Proposing Release also confirms that the location of relevant activity of any third party agents for either the SBSD or its counterparty must be considered.
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As further discussed below, the “transaction conducted within the United States” definition could also determine whether the transaction reporting, public dissemination, trade execution and mandatory clearing requirements apply to an SBS transaction. A broad interpretation of the definition that encompasses each of the specified activities, without exception or qualification, could adversely affect the willingness of non-U.S. persons to use the services of independent U.S.-based advisors, including investment managers and counsel, for example, that participate in negotiating the terms of an SBS transaction.

3. Activities that Do Not Render an SBS Transaction “Conducted Within the United States”

The Proposing Release indicates that neither submitting a transaction for clearing in the United States nor reporting a transaction to an SBS swap data repository (“SBSDR”) in the United States would cause the transaction to be “conducted within the United States” for purposes of the Proposed Rules. The Proposing Release also indicates that the SEC would not treat “activities related to collateral management (for example, exchange of margin payments) that may occur in the United States or involve U.S. banks or custodians” as activity “conducted within the United States” for purposes of the Proposed Rules. 8 Aside from the “exchange of margin payments,” the Proposing Release does not indicate what other “activities related to collateral management” would fall within this exclusion.

4. Foreign Branch Exception

Under the Proposed Rules, transactions conducted within the United States would not include a “transaction conducted through a Foreign Branch.” In order for a transaction to fall within that exception, the Foreign Branch must be the named counterparty to the transaction and the transaction must not have been solicited, negotiated or executed by a person within the United States on behalf of the Foreign Branch or its counterparty. 9 (A transaction conducted through a Foreign Branch could be booked in the United States, however.)

As in the case of transactions that are not “conducted within the United States” for the purposes of the Proposed Rules, a counterparty to an SBS transaction with a Foreign Branch would be able to rely, absent actual knowledge to the contrary, on a representation from the Foreign Branch that “no person within the United States is directly involved in soliciting, negotiating, or executing the [SBS transaction] on behalf of” the Foreign Branch. Like non-U.S. SBSDs, Foreign Branches may face some uncertainty as to whether a person within the United States was so involved. The Proposing Release provides no guidance on the level of logistical or other support from within the United States (for example, through reliance on home office documentation or central credit committee personnel or the services of independent investment managers or counsel) that would amount to “direct involvement” in the solicitation, negotiation or execution of an SBS transaction.
III. FOREIGN SBSD REGISTRATION AND CALCULATION OF THE DE MINIMIS AMOUNT

A. CALCULATION OF THE DE MINIMIS AMOUNT FOR SBSDS

In general, SEC rules provide that a person that is not registered as an SBSD shall not be deemed to be an SBSD if the aggregate effective notional amount of SBS transactions entered into in connection with the person’s dealing activity together with the dealing activity of certain affiliates over the preceding 12 months did not exceed a “de minimis amount” of $3 billion (in the case of credit default swaps) or $150 million (in the case of other SBS transactions). In the cross-border context, several commenters had requested that the SEC adopt an approach modeled on Rule 15a-6(a)(3) under the Exchange Act, which would permit a non-U.S. person to conduct SBS dealing activity within the United States without registering as an SBSD if its SBS transactions were intermediated by a registered SBSD. The SEC rejected that approach, noting that the party bearing the financial risk of the transaction (i.e., the non-U.S. person) is the party whose financial integrity is of primary concern to the SEC in the context of SBS transactions.

The Proposed Rules specify how U.S. and non-U.S. persons should determine whether their SBS dealing activity exceeds the applicable de minimis amount and the circumstances under which U.S. and non-U.S. persons will be required to aggregate the positions of U.S. and non-U.S. affiliates as part of their own de minimis calculations. The operation of these provisions, if adopted, could enable some non-U.S. dealers to avoid registration as SBSDs.

1. De Minimis Calculations for the SBSD’s Own Cross-Border Positions
   a. U.S. Persons
      In determining whether its dealing activities exceed the applicable de minimis amount for purposes of the SBSD registration requirement, a U.S. person would be required to count all the SBS transactions it conducts in a dealing capacity (including transactions conducted through a Foreign Branch), other than SBS transactions with majority-owned affiliates, as described in Section III.A.1.c below.
   b. Non-U.S. Persons
      i. Cross-Border Positions
         A non-U.S. person, on the other hand, would be required to count against its de minimis amount, SBS transactions in a dealing capacity only to the extent any such transaction is conducted with a “U.S. person” or constitutes a “transaction conducted within the United States” (other than any transaction conducted through a Foreign Branch to the extent described in the next paragraph, and transactions with majority-owned affiliates as described in Section III.A.1.c below). Accordingly, although an SBS transaction between a non-U.S. person and a U.S. person (other than a Foreign Branch) would be counted against the non-U.S. person’s de minimis amount even if the transaction were conducted outside the United States, an SBS transaction between two non-U.S. persons conducted outside the United States would not be counted against either person’s de minimis amount.
States would not be counted against the de minimis amount, even if the obligations of one or both of the counterparties were guaranteed by U.S. persons.

ii. Exclusion of Transactions by non-U.S. Persons with Foreign Branches

The SEC recognizes that imposing registration requirements on non-U.S. persons solely on the basis of their SBS dealing activity with Foreign Branches could limit U.S. bank access to non-U.S. counterparties when those banks conduct their SBS dealing activity through Foreign Branches. Accordingly, the Proposed Rules would allow a non-U.S. person to exclude an SBS transaction with a Foreign Branch from the calculation of the non-U.S. person’s de minimis amount, provided that the SBS transaction was a “transaction conducted through a Foreign Branch” (i.e., was not solicited, negotiated or executed by a person within the United States on behalf of either counterparty), as further described in Section II.B.4 above.

iii. Exclusion of Non-U.S. Person Positions Guaranteed by U.S. Persons

A non-U.S. person whose performance under an SBS transaction is guaranteed by a U.S. person would not be required to count against its de minimis amount, dealing transactions with non-U.S. counterparties that are not conducted within the United States, as would be required of a U.S. person that entered into the SBS transaction directly. In addition, a non-U.S. person (whether or not its performance is guaranteed by a U.S. person) would not be required to count toward its de minimis amount, SBS transactions with non-U.S. counterparties whose performance is guaranteed by U.S. persons.

c. Exclusion of Transactions Among Majority-Owned Affiliates

Under the Proposed Rules, all cross-border SBS transactions among “majority-owned affiliates” would be disregarded in determining whether a person is an SBSD. According to the Proposing Release, two parties would be considered majority-owned affiliates “if one party directly or indirectly owns a majority interest in the other, or if a third party directly or indirectly owns a majority interest in both, based on the right to vote or direct the vote of a majority of a class of voting securities of an entity, the power to sell or direct the sale of a majority of a class of voting securities of an entity, or the right to receive upon dissolution or the contribution of a majority of the capital of a partnership.” This exclusion would apply to U.S. persons as well as non-U.S. persons and the Proposing Release clarifies that this exclusion would apply even if the inter-affiliate transaction is a back-to-back transaction in which a non-U.S. subsidiary acts as a conduit for its U.S. affiliate.

B. AGGREGATION RULES FOR DE MINIMIS CALCULATIONS

In their May 2012 release entitled the “Further Definition of ‘Swap Dealer,’ ‘Security-Based Swap Dealer,’ ‘Major Swap Participant,’ ‘Major Security-Based Swap Participant’ and ‘Eligible Contract Participant’” (the “Intermediary Definitions Adopting Release”), the SEC and the CFTC proposed an affiliate aggregation principle that would require a potential SBSD or swap dealer to count all dealing activity of its affiliates against its own de minimis amount. The Proposed Rules, though in large measure consistent with the
approach taken in the Intermediary Definitions Adopting Release, reflect a number of exceptions and other changes to this aggregation principle.

The guidance on aggregation in the Intermediary Definitions Adopting Release employs familiar definitions that are used elsewhere in the Exchange Act. “Affiliate” is defined as a person or other entity “controlling, controlled by or under common control with” the person at issue and “control” means “the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract or otherwise.”

If a person (whether U.S. or non-U.S.) engages in any SBS dealing activity that would be counted against its own de minimis amount, then under the Proposed Rules that person’s transactions would be aggregated with those of all of its affiliates, in each case to the extent the affiliate’s transactions were required to be counted against that affiliate’s own de minimis amount. Subject to the important exception discussed below for operationally independent SBSDs, if the aggregate SBS dealing activity of an affiliated group, as so calculated, exceeds the de minimis amount, each of the affiliates that had any transaction included in the de minimis calculation would be required to register with the SEC as an SBSD.

1. Exclusion of Transactions by Registered “Operationally Independent” SBSD Affiliates

Under the Proposed Rules, any person (U.S. or non-U.S.) would be permitted to exclude from the calculation of its de minimis amount, the SBS dealing transactions of any affiliate that is registered with the SEC as an SBSD, as long as the person’s SBS activities are “operationally independent” from those of the registered SBSD affiliate. The SBS activities of two affiliated persons would be considered “operationally independent” if the affiliated persons “maintained separate sales and trading functions, operations (including separate back offices), and risk management with respect to any security-based swap dealing activity conducted by either affiliate that is required to be counted against their respective de minimis amounts.” If any of these functions are jointly administered by the two affiliates, or are managed at a central location within the corporate group of which the affiliates are members, the Proposed Rule would not allow the unregistered affiliate to exclude from its de minimis calculation the SBS dealing activities of its registered SBSD affiliate.

C. DIFFERENCES FROM THE CFTC’S APPROACH

The SEC’s proposed approach to the calculation of the de minimis amount differs from the CFTC’s proposed approach in a number of respects, including the following:

- In contrast to the SEC, the CFTC proposes to require a non-U.S. dealer whose obligations are guaranteed by a U.S. person to count against such non-U.S. dealer’s de minimis amount all swaps entered into by it in a dealing capacity, whether the counterparty is a U.S. person or a non-U.S. person.
- While the SEC would not require a non-U.S. person to count against its de minimis amount any SBS transactions with a Foreign Branch, the CFTC would permit a corresponding exclusion only for swaps between a non-U.S. person and the Foreign Branch of a registered swap dealer.
The CFTC’s proposal would not provide any exclusion for the aggregation of swap positions of registered swap dealers (other than the time-limited exception specified in the next paragraph), while the SEC proposes to permit the exclusion of SBS transactions with operationally independent registered SBSDs (whether U.S. or non-U.S.). Like the Proposed Rules, however, the CFTC’s proposal would not require a non-U.S. person to count swaps entered into with its U.S. affiliates against its de minimis amount.

The SEC’s proposed treatment of conduit entities and guaranteed entities differs from the approach taken by the CFTC in its proposal. Unlike the Proposing Release, the CFTC’s proposal would require a U.S. person to register as a swap dealer as a result of inter-affiliate swap transactions with an affiliated non-U.S. dealer if the non-U.S. dealer is acting as a conduit by transferring swaps to the U.S. person through back-to-back transactions. The SEC, on the other hand, would not require a U.S. person to register as an SBSD as a result of back-to-back transactions with a non-U.S. person affiliate that acts as a conduit for the U.S. person, unless there is a basis for requiring the U.S. person to register as an SBSD that is unrelated to such inter-affiliate transactions.

Relatedly, the CFTC has also proposed an interpretation that would subject a U.S. person to swap dealer registration requirements where the U.S. person operates a “central booking system,” under which swaps are booked to it, without regard to whether such U.S. person enters into the swap directly or indirectly through a back-to-back arrangement with its affiliate. In contrast, the SEC would only subject a central booking entity to SBSD registration requirements where the central booking entity directly enters into SBS transactions. Back-to-back arrangements between the central booking entity and its affiliates would be disregarded.

The CFTC has provided time-limited relief to certain non-U.S. persons currently engaged in swap dealing with U.S. persons. Pursuant to that relief, a non-U.S. person that is (i) engaged in swap dealing with U.S. persons as of January 7, 2013, and (ii) an affiliate of a registered swap dealer is not required to count against its de minimis amount the effective notional amount of any swaps of any non-U.S. affiliate that is (a) either engaged in swap dealing activities with U.S. persons as of January 7, 2013 or (b) registered as a swap dealer. However, absent further action from the CFTC, this relief will expire on July 12, 2013.

IV. TITLE VII REQUIREMENTS APPLICABLE TO SBSDS

A. ENTITY-LEVEL AND TRANSACTION-LEVEL REQUIREMENTS; MARGIN REQUIREMENTS TREATED AS ENTITY-LEVEL

A person whose SBS dealing activities exceed the de minimis amount must register as an SBSD with the SEC and thereby becomes subject to a number of entity-level and transaction-level requirements imposed under Title VII. Entity-level requirements, such as capital requirements, primarily address concerns with respect to the SBSD as a whole (including the safety and soundness of, and systemic risks to, the U.S. financial system), while transaction-level requirements, such as external business conduct standards, focus on the protection of an SBSD’s counterparties.

Notably, in the Proposing Release, the SEC proposes to treat margin requirements for non-cleared SBS transactions as entity-level requirements rather than transaction-level requirements. The SEC believes that treating margin as an entity-level requirement is consistent with its understanding of margin as one of an integrated collection of financial responsibility requirements that are meant to enhance the financial reliability of SBSDs.

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By contrast, the CFTC would treat margin as a transaction-level requirement and would apply margin requirements to cross-border swap transactions in the same manner as other transaction-level requirements.

1. Transaction-Level Requirements

In the Proposing Release, the SEC identifies its rules that impose external business conduct standards and require the segregation of customer property as the most significant transaction-level requirements applicable to SBSDs, and discusses the extent to which each of these requirements will apply to SBSDs in the context of their cross-border dealing activities.

a. External Business Conduct Standards

Section 15F(h) of the Exchange Act requires the SEC, by rule, to adopt external business conduct standards for SBSDs.27 Under the Proposed Rules, an SBSD would not be subject to those external business conduct rules with respect to any SBS transaction that is part of an SBSD’s “Foreign Business.” The sole exception to this approach are the rules requiring an SBSD to diligently supervise its business,28 which the SEC would treat as an entity-level requirement, discussed in Section IV.A.2 below.

The Proposed Rules define “Foreign Business” in the negative, that is, as SBS transactions entered into, or offered to be entered into, by or on behalf of an SBSD, other than the “U.S. Business” of the SBSD.29 The Proposed Rules would provide different definitions of “U.S. Business” for U.S. SBSDs and non-U.S. SBSDs.

- If an SBSD is not a U.S. person, its “U.S. Business” would be limited to any “transaction conducted within the United States,” or entered into or offered to be entered into by or on behalf of the SBSD with a U.S. person (other than a Foreign Branch).30
- If an SBSD is a U.S. person, its “U.S. Business” would include any transaction by or on behalf of the SBSD, wherever it occurs,31 except for any transaction conducted by a Foreign Branch with a non-U.S. person or another Foreign Branch.32

Because the proposed U.S. Business definition is narrower for a non-U.S. SBSD than for a U.S. SBSD, the definition of “Foreign Business” would be broader and the potential relief from the external business conduct standards would be greater for non-U.S. SBSDs. With respect to a Foreign Branch, Foreign Business would include any SBS transaction to which a non-U.S. person or another Foreign Branch was the counterparty, provided that the SBS transaction satisfied the “transaction conducted through a Foreign Branch” definition.

The SEC’s proposal to exempt non-U.S. SBSDs and Foreign Branches from most external business conduct standards with respect to Foreign Business is based on Dodd-Frank’s focus on the protection of U.S. counterparties and U.S. markets. The SEC states that foreign counterparties typically would not expect to receive the customer protections of Title VII when dealing with non-U.S. SBSDs outside the United States.
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respect to assets received from, for, or on behalf of, a counterparty that is a U.S. person. The same segregation requirement also applies to non-U.S. SBSDs that are not registered as broker-dealers but that are foreign banks with a branch or agency within the United States.

### iii. Cleared SBS Transactions

The segregation requirements applicable to non-U.S. SBSDs with respect to assets received from, for, or on behalf of, a counterparty to margin, secure or guarantee cleared SBS transactions would depend on the status of the non-U.S. SBSD.

(i) A non-U.S. SBSD that is a registered broker-dealer would be required to comply with the segregation requirements under Section 3E of the Exchange Act, and the rules thereunder, with respect to any assets received from, for, or on behalf of, any counterparty.

(ii) A non-U.S. SBSD that is not a registered broker-dealer but is a foreign bank with a branch or agency in the United States would be subject to the same segregation requirements as a registered broker-dealer, but only with respect to assets that it receives from, for, or on behalf of, a counterparty that is a U.S. person. The special account maintained by such an SBSD pursuant to those segregation requirements would be required to be designated for the exclusive benefit of U.S. person SBS customers.

(iii) A non-U.S. SBSD that is neither a foreign bank with a branch or agency in the United States nor a registered broker-dealer, would be required to comply with the segregation requirements under Section 3E of the Exchange Act, and the rules thereunder, with respect to any assets received from, for, or on behalf of, any counterparty, but only if the non-U.S. SBSD receives collateral from any U.S. person counterparty in order to margin, guarantee or secure a cleared SBS.

### c. Disclosure Requirements

Before a non-U.S. SBSD accepts any assets from, for, or on behalf of, any U.S. counterparty to margin, guarantee or secure an SBS transaction, the Proposed Rules would require the non-U.S. SBSD to disclose to the counterparty the potential treatment of the segregated assets under U.S. bankruptcy law and other applicable insolvency laws. Specifically, under the Proposed Rules, the non-U.S. SBSD would be required to disclose any relevant considerations that may affect the treatment of the segregated assets, including whether:

- the non-U.S. SBSD is subject to segregation requirements with respect to the assets to be accepted from the U.S. person counterparty;
- the non-U.S. SBSD is subject to the stockbroker liquidation provisions of the U.S. Bankruptcy Code; and
- the segregated assets could be treated as “customer property” under U.S. bankruptcy law.
d. Other Requirements

The Proposing Release states that all other transaction-level requirements would apply to all SBSDs (both U.S. and non-U.S.). Substituted compliance would not be permitted for U.S. SBSDs, including those that conduct dealing activity through Foreign Branches (which themselves fall within the definition of U.S. person and are treated as such for this purpose), although the SEC indicates that it is proposing to establish a framework to permit substituted compliance by non-U.S. SBSDs under certain circumstances (discussed in Section VIII.A.3 below).

2. Certain Entity-Level Requirements

The Proposing Release acknowledges that capital, margin and other entity-level requirements applicable to SBSDs have a substantial impact on the competitive position of firms operating in multiple jurisdictions. Other entity-level requirements include those relating to risk management, recordkeeping and reporting, internal systems and controls, diligent supervision, conflicts of interest, the designation of a chief compliance officer, inspection and examination, and licensing and statutory disqualification. The SEC’s proposal not to provide relief from entity-level requirements for non-U.S. SBSDs is based on the SEC’s view that entity-level requirements are at the core of the SEC’s responsibility to ensure the financial safety and soundness of registered SBSDs generally. Accordingly, the Proposed Rules would not provide specific relief from the entity-level requirements in connection with cross-border SBS activity, although in certain cases a non-U.S. SBSD could satisfy its entity-level obligations through substituted compliance (discussed in Section VIII.A.3 below).
regardless of the identity of the counterparty. For purposes of the MSBSP definition, however, the presence of a U.S. person as a party to the SBS transaction is important, rather than the location of the transaction. The SEC believes that the MSBSP status determination focuses on risks to the U.S. financial system, which are greater where the counterparties are U.S. persons, whereas the SBSD determination emphasizes, in addition to risks, the nature of an entity’s activities, its interactions with counterparties and its role in the SBS market.

Despite acknowledging a number of comments to the contrary, the SEC would also specifically require non-U.S. persons to include in their MSBSP calculations SBS transactions with Foreign Branches. The SEC notes that Foreign Branches are not separate legal persons and believes that the counterparty default risks posed by a non-U.S. person would not differ whether the non-U.S. person entered into the SBS transaction with the home office of a U.S. person or with the Foreign Branch of such person.

c. Exclusion of Transactions Among Majority-Owned Affiliates

The Proposing Release does not include any discussion of how SBS transactions with a person’s majority-owned affiliates should be treated for purposes of the MSBSP determination in the cross-border context. The Intermediary Definitions Adopting Release, however, deals with this topic more generally. It states that in determining its MSBSP status, neither a U.S. person nor a non-U.S. person will be required to include swap or SBS transactions with counterparties that are majority-owned affiliates. The Intermediary Definitions Adopting Release uses the same definition of “majority-owned affiliate” for this purpose as the Proposing Release uses for the corresponding exclusion from the de minimis amount calculation. Accordingly, the Proposing Release does not affect the scope of the SEC’s earlier rule in the Intermediary Definitions Adopting Release.

d. Treatment of Guaranteed Positions

i. Attribution Rules Applicable to U.S. Person Guarantors

For purposes of the MSBSP determination under the Proposed Rules, a U.S. person that guarantees the SBS obligations of a non-U.S. person would, subject to the exceptions discussed below in Section V.A.1.d.iii, attribute to itself all of the non-U.S. person’s SBS positions that it guarantees, whether the non-U.S. person’s transaction counterparty is a U.S. person or a non-U.S. person. The attribution of guaranteed positions for purposes of the MSBSP determination is intended to reflect the risk that the guarantor might pose to the U.S. financial system as a result of such guarantees.

ii. Attribution Rules Applicable to Non-U.S. Person Guarantors

The SEC notes that where a non-U.S. person guarantor defaults on a guarantee on the performance of an SBS transaction by a U.S. person, the full amount of risk accumulated under the guaranteed U.S. person’s SBS positions would directly affect the U.S. financial system. Therefore, for the purpose of the MSBSP determination, a non-U.S. person would, subject to the exceptions discussed in the following paragraph, attribute to itself the SBS positions that it guarantees, of:
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- all U.S. persons; and
- all non-U.S. persons with U.S. person counterparties.\(^{48}\)

### iii. Exceptions to Attribution Requirement

In interpretive guidance in the Intermediary Definitions Adopting Release, the SEC and the CFTC stated that a guarantor would not be required to attribute to itself any positions of a person that it guarantees if that person is subject to capital regulation by the SEC or the CFTC, or if that person is a U.S. entity regulated as a bank in the United States. The Proposing Release extends this guidance to the cross-border context by proposing that no guarantor would be required to attribute to itself, for the purpose of the MSBSP determination, the SBS positions of a non-U.S. entity that is subject to capital regulation by the SEC or the CFTC, or that is subject to capital standards adopted by its home-country supervisor that are consistent in all respects with the Capital Accord of the Basel Committee on Banking Supervision.\(^{49}\)

### e. Delegation of Operational Compliance

The interpretive guidance in the Intermediary Definitions Adopting Release also clarifies that an entity, such as a guarantor, that becomes an MSBSP by virtue of positions entered into by others must be responsible for compliance with all applicable MSBSP entity-level requirements, but may delegate operational compliance with transaction-level requirements to entities that directly enter into such positions. The Proposing Release extends this guidance in the cross-border context, by providing that an MSBSP may delegate compliance duties for transaction-level requirements (and for entity-level requirements that “have a transaction focus, such as margin”) to the entities that are direct counterparties to the relevant transactions. The MSBSP would remain responsible, however, for ensuring compliance with the delegated transaction-level requirements applicable to such transactions.\(^{50}\)

### 2. Foreign Public Sector Financial Institutions as MSBSPs

The SEC received a number of comments regarding the treatment of Foreign Public Sector Financial Institutions (“FPSFIs”) — particularly comments asserting that FPSFIs should be excluded from the MSBSP definition because they are already subject to comparable or comprehensive substantive regulation by regulators in their home jurisdictions and because FPSFIs must comply with extremely high risk and capital controls and therefore do not threaten systemic stability.

The SEC observed that FPSFIs “encompass a wide range of institutions and organizations, ranging from divisions of foreign central banks, to international financial institutions established under treaties, to multilateral development banks formed, owned, and controlled by sovereign members, to sovereign wealth funds and other investment corporations owned by foreign governments” and that “FPSFIs raise unique and complex issues.”\(^{51}\) Citing a lack of “information regarding the types, levels, and natures of SBS activity in which FPSFIs regularly engage, the Proposing Release does not specifically address the treatment of FPSFIs as MSBSPs. Instead, the SEC invites comment to determine the basis on which FPSFIs might be excluded from the application of the MSBSP definition to non-U.S. persons.
3. Requirements Applicable to non-U.S. MSBSPs

In general, Title VII subjects registered MSBSPs and SBSDs to the same entity-level, transaction-level and segregation requirements. However, the SEC believes that the objectives of Title VII do not require that non-U.S. MSBSPs be subject to Title VII’s customer protection requirements with respect to their dealings with non-U.S. persons. Accordingly, the SEC proposes to apply the transaction-level and entity-level requirements to non-U.S. MSBSPs in the manner described below.

a. Transaction-Level Requirements

Under the Proposed Rules, in its transactions with non-U.S. persons, a non-U.S. MSBSP would not be subject to the external business conduct standards established pursuant to Section 15F(h) of the Exchange Act, other than the rules relating to the diligent supervision of its business. In addition, in its transactions with non-U.S. persons, a non-U.S. MSBSP that is not a registered broker-dealer would not have to comply with segregation requirements for assets held as collateral.

b. Entity-Level Requirements

While the Proposing Release notes that capital and margin are the “most significant” entity-level requirements, the SEC appears to propose that non-U.S. MSBSPs would be required to adhere to all entity-level requirements, not just those relating to capital and margin. As a result, and in the absence of any further exemptions from the SEC, non-U.S. MSBSPs would be required to comply with not only capital and margin requirements but also other requirements such as risk management procedures, requirements as to books and records, the creation of conflict of interest systems and the designation of a chief compliance officer.

4. No Substituted Compliance for non-U.S. MSBSPs

The Proposed Rules do not contemplate a substituted compliance regime for non-U.S. MSBSPs. The SEC notes that it has limited information regarding the types of non-U.S. entities that may become MSBSPs and the non-U.S. regulatory regimes that may apply to these entities. The SEC will continue to consider whether substituted compliance may be appropriate for non-U.S. MSBSPs in light of comments received on the Proposing Release and subsequent market developments.

VI. PROPOSED REGULATION SBSR

A. BACKGROUND

Sections 13(m) and 13(n) of the Exchange Act require the SEC to adopt rules relating to the reporting of SBS transactions and the public dissemination of certain SBS transaction data, volume and related pricing information. In November 2010, the SEC proposed Regulation SBSR, Rules 900 through 911 under the Exchange Act, to address those requirements (the “November 2010 Proposal”).
As originally proposed, Regulation SBSR would have required that three categories of information be reported to registered SDRs:

- information to be reported in real time (generally no more than 15 minutes after a trade is entered into) and immediately publicly disseminated;
- additional information, to be reported within specified times, but not publicly disseminated; and
- updates needed due to changes to previously reported information.

B. MODIFICATIONS TO PROPOSED REGULATION SBSR

In response to comments submitted on the November 2010 Proposal, the Proposed Rules include significant modifications to Regulation SBSR, including those relating to the application of the regulation in the cross-border context.

1. The Definition of “U.S. Person”

The November 2010 Proposal would have defined a “U.S. person” as a natural person who is a U.S. citizen or U.S. resident, or a legal person organized under the “corporate laws” of any part of, or with its principal place of business in, the United States. For consistency and transparency, the Proposed Rules would modify the definition of “U.S. person” in Regulation SBSR to conform with the definition used elsewhere in the Proposed Rules (see the discussion of that definition in Section II.A above).

2. Reporting Requirements

The November 2010 Proposal would have required reporting of any SBS transaction that (i) had at least one counterparty that is a U.S. person, (ii) was executed in the United States, or through any means of interstate commerce, or (iii) was cleared by a clearing agency with its principal place of business in the United States. The mere existence of a guarantee provided by a U.S. person would not have been sufficient to create a reporting obligation.

The Proposed Rules would modify the reporting requirements under Regulation SBSR to replace the reference to an SBS transaction executed “through any means of interstate commerce,” with a reference to any SBS “transaction conducted within the United States” as that term is defined elsewhere in the Proposed Rules (see the discussion of the definition of that phrase in Section II.B above). Also, under the Proposed Rules, the reporting obligation would apply to any SBS transaction under which at least one party or a guarantor of a party is a U.S. person, SBSD or MSBSP.

Thus, under Regulation SBSR as set forth in the Proposing Release, an SBS transaction would be subject to regulatory reporting if any of the following conditions is met:

- the SBS transaction is a transaction conducted within the United States;
- a U.S. person is a direct counterparty or guarantor on either side of the transaction, regardless of where the transaction is conducted;
an SBSD or MSBSP is a direct counterparty or guarantor on either side of the transaction, regardless of where the transaction is conducted; or

3. Public Dissemination Requirements

Regulation SBSR’s public dissemination requirements also would be modified from those contained in the November 2010 Proposal. As modified in the Proposed Rules, Regulation SBSR would require public dissemination of the applicable data with respect to an SBS transaction if any of the following conditions is met:

- the SBS is a transaction conducted within the United States;
- a U.S. person is a direct counterparty or guarantor on each side of the transaction, regardless of where the transaction is conducted;
- at least one direct counterparty is a U.S. person, regardless of where the transaction is conducted (except in the case of a transaction conducted through a Foreign Branch);
- one side of the transaction includes (as a direct counterparty or a guarantor) a U.S. person and the other side includes (as a direct counterparty or a guarantor) a non-U.S. person that is an SBSD, regardless of where the transaction is conducted; or
- the SBS is cleared through a clearing agency that has its principal place of business in the United States.  

Unlike in the case of the reporting rules, the public dissemination requirement would not necessarily be triggered by the presence of an SBSD or MSBSP as a direct counterparty or guarantor to an SBS transaction. For an SBS transaction that is not conducted within the United States, public dissemination would not be required as long as no U.S. person is a direct counterparty to the transaction and U.S. persons do not guarantee both sides of the transaction. By contrast, public dissemination would be required, regardless of the location of the transaction, where one side of an SBS transaction includes a U.S. person (as counterparty or guarantor) and the other side, although comprising only non-U.S. persons, includes a non-U.S. SBSD (as counterparty or guarantor). In the Proposing Release, the SEC states that the public dissemination of data relating to SBS transactions between a U.S. person and a non-U.S. SBSD is necessary to achieve regulatory goals such as information symmetry, lower transaction costs, higher market confidence and increased liquidity in the SBS market.

4. Reporting Responsibility

a. Entities Not Subject to Regulation SBSR

As set forth in the November 2010 Proposal, Regulation SBSR would not have imposed reporting obligations on a counterparty to an SBS unless (i) the counterparty was a U.S. person, (ii) the SBS was executed within the United States or through any means of interstate commerce, or (iii) the SBS was cleared through a clearing agency whose principal place of business is in the United States.
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The SEC proposes to modify this framework to conform to the other changes made to Regulation SBSR through the Proposed Rules. A counterparty (which, for purposes of Regulation SBSR, would include a guarantor) to an SBS transaction would not incur any reporting obligation under Regulation SBSR, as modified in the Proposing Release, unless:

- the counterparty is a U.S. person;
- the counterparty is an SBSD or MSBSP; or
- the SBS is a transaction conducted within the United States.  

Thus, under the Proposed Rules, a non-U.S. counterparty, including a guarantor, that is not an SBSD or MSBSP would not become responsible for reporting an SBS transaction merely because the transaction was cleared through a U.S. clearing agency.

b. Reporting Sides and the Duty to Report

The November 2010 Proposal would have defined “reporting party” as the counterparty to an SBS transaction with the duty to report information to an SDR or, in the absence of an SDR, to the SEC. That proposal would have allocated reporting duties as follows:

- where only one counterparty was a U.S. person, the U.S. person would have been the reporting party;
- where both counterparties were U.S. persons, but only one counterparty was an SBSD or MSBSP, the SBSD or MSBSP would have been the reporting party;
- where both counterparties were U.S. persons, but one counterparty was an SBSD and the other an MSBSP, the SBSD would have been the reporting party; and
- for any other SBS, including when neither counterparty was a U.S. person, the counterparties would be required to select the reporting party.

The Proposed Rules would replace the concept of “reporting party” with that of “reporting side,” which includes any direct counterparty or guarantor on either side of the SBS transaction.  

Under this modified framework:

- if both sides include an SBSD, the sides would be required to select a reporting side;
- if only one side includes an SBSD, the side which has the SBSD would bear the reporting obligation;
- if both sides include an MSBSP, the sides would be required to select a reporting side;
- if one side includes an MSBSP and the other side includes neither an SBSD nor an MSBSP, the side with the MSBSP would bear the reporting obligation;
- if neither side includes an SBSD or MSBSP and only one side includes a U.S. person, the side with the U.S. person would bear the reporting obligation; and
- if neither side of the SBS includes an SBSD or MSBSP and either both sides include a U.S. person or neither side includes a U.S. person, the sides would be required to select a reporting side.
Where a reporting side has the reporting obligation, that obligation may be fulfilled by either the direct counterparty or the guarantor on that side.

5. Substituted Compliance for Regulation SBSR Obligations

The November 2010 Proposal did not contemplate that market participants would be able to satisfy their reporting and public dissemination obligations with respect to cross-border SBS transactions through substituted compliance. As discussed below, however, Regulations SBSR as modified in the Proposed Rules would provide for substituted compliance in certain circumstances.

6. Cross-Border Inter-Affiliate SBS Transactions

The SEC received a number of comments expressing concern about application of the Title VII reporting and public dissemination requirements to cross-border inter-affiliate SBS transactions. The Proposing Release notes the SEC’s preliminary view that the reporting and public dissemination requirements serve different purposes and should be considered separately.

With respect to regulatory reporting, the Proposing Release notes that the Exchange Act reporting requirement by its terms applies to each SBS transaction, and does not distinguish any transaction based on its particular characteristics. Accordingly, the SEC has not proposed to modify the reporting obligation with respect to cross-border inter-affiliate SBS transactions.

With respect to public dissemination of cross-border inter-affiliate SBS transaction data, the SEC notes that many of the concerns raised by commenters are similar to those raised in the context of domestic inter-affiliate SBS transactions. A common theme in the comments has been the relative lack of price discovery value or the false understanding of the transaction that might result from such dissemination. However, the Proposing Release notes the SEC’s preliminary view that cross-border inter-affiliate SBS transactions should not be excluded generally from the public dissemination requirements of Regulation SBSR. The SEC believes that the commenters’ concerns can instead be addressed through the adopting release on Title VII’s public dissemination requirements, which the SEC anticipates will address the issue of dissemination of inter-affiliate SBS transaction data.

7. Foreign Privacy Laws and Counterparty Identity Reporting

As originally proposed, Rule 901(d) would have required that the regulatory report for each SBS submitted by the “reporting party” include the identity of each counterparty. At that time, the SEC indicated that knowing the identities of both counterparties would give the SEC the ability to more effectively carry out its market oversight duties. Disclosure of the non-reporting counterparty’s identity may, however, pose a challenge for U.S. persons where the SBS transaction is executed outside the United States. Commenters identified certain specific non-U.S. legal regimes under which no disclosure of a non-reporting party’s identity may be made without its consent. In response to these and other comments, the Proposing Release seeks further information on foreign privacy laws, the restrictions they
might impose on counterparty identity reporting, and whether the use of a substituted compliance regime might resolve obstacles to reporting from non-U.S. privacy laws.\textsuperscript{65}

8. Treatment of FPSFIs

In the November 2010 Proposal, SBS transactions involving FPSFIs would have been subject to the reporting and public dissemination requirements of Regulation SBSR. A number of commenters, including foreign central banks and multilateral development banks, expressed concerns regarding the application of Title VII requirements to the activities of FPSFIs. Other commenters argued that SBS transactions entered into by foreign central banks and multilateral development banks should generally not be regulated as SBS transactions for the purposes of Title VII. In the Proposing Release, however, the SEC states that the inclusion of an FPSFI as a counterparty to an SBS transaction would not be sufficient to exempt the transaction from the regulatory reporting or public dissemination requirements generally applicable to SBS transactions.\textsuperscript{66} The Proposing Release invites further comment on this issue.

VII. MANDATORY CLEARING AND TRADE EXECUTION

A. THE MANDATORY CLEARING AND TRADE EXECUTION REQUIREMENTS

Sections 3C(a)(1) and 3C(h)(1) of the Exchange Act require that SBS transactions be subject to mandatory clearing and trade execution requirements. The Proposed Rules would apply the mandatory clearing and trade execution requirements to a cross-border SBS transaction if (i) at least one counterparty to the transaction is a U.S. person, or a non-U.S. person whose performance under the transaction is guaranteed by a U.S. person, or (ii) the transaction is a transaction conducted within the United States (see the discussion relating to that definition in Section II.B above).\textsuperscript{67}

Under the Proposed Rules, the mandatory clearing and trade execution requirements would apply to transactions outside the United States between a U.S. person and a non-U.S. SBSD, or between non-U.S. persons where the performance of at least one such non-U.S. person is guaranteed by a U.S. person.\textsuperscript{68} The SEC believes that applying the mandatory clearing requirement in this way is appropriate in light of the ultimate risk that the covered transactions would present for the U.S. financial system. The Proposing Release also notes that the mandatory clearing and trade execution requirements would apply to SBS transactions conducted within the United States, even if the conduct within the United States is limited only to soliciting or negotiating the transaction.\textsuperscript{69} The SEC invites comments on whether the clearing requirement should extend to such transactions involving limited conduct within the United States.

B. EXCEPTIONS TO THE MANDATORY CLEARING AND TRADE EXECUTION REQUIREMENTS

The Proposed Rules would provide two exceptions to the mandatory clearing and trade execution requirements for cross-border SBS transactions:\textsuperscript{70}
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For an SBS transaction that is not a “transaction conducted within the United States,” the mandatory clearing and trade execution requirements would not apply if (i) one counterparty to the SBS is either (A) a Foreign Branch or (B) a non-U.S. person whose performance under the SBS is guaranteed by a U.S. person, and (ii) the other counterparty to the SBS is a non-U.S. person (A) whose performance on the SBS is not guaranteed by a U.S. person and (B) who is not an SBSD.

For an SBS transaction that is a “transaction conducted within the United States,” the mandatory clearing and trade execution requirements would not apply if (i) neither counterparty to the SBS is a U.S. person, (ii) neither counterparty’s performance under the SBS is guaranteed by a U.S. person, and (iii) neither counterparty to the SBS is an SBSD.

The Proposing Release indicates that these exceptions represent a compromise between guarding against risks to the U.S. financial system and maintaining the competitiveness of U.S. market participants. According to the SEC, the first exception would allow Foreign Branches and non-U.S. persons who are guaranteed by U.S. persons to access non-U.S. SBS markets. In the absence of such an exception, the SEC believes that non-U.S. counterparties would be less willing to enter into SBS transactions with Foreign Branches or non-U.S. persons whose performance is guaranteed by U.S. persons, which would place U.S. banks and U.S.-guaranteed non-U.S. persons at a competitive disadvantage.

The SEC declined to provide U.S. persons with a broad exception from mandatory clearing for cross-border SBS transactions. In the SEC’s view, such an exception would undermine the regulatory goal of reducing risk to the U.S. financial system. The Proposing Release further notes that the proposed uniform mandatory clearing requirement for all U.S. persons other than Foreign Branches and guaranteed non-U.S. persons should result in the development of central clearing infrastructures and the standardization of contract terms. The SEC notes that transactions between two non-U.S. persons whose obligations under an SBS are not guaranteed by a U.S. person do not pose the same risk to the U.S. financial system as transactions involving U.S. persons as counterparties or guarantors.

In the context of the trade execution requirement, the SEC states that the second exception above is required because many non-U.S. persons currently prefer to use U.S. agents to enter into transactions (which thereby become “transactions conducted within the United States”), especially for reasons such as market expertise or logistical convenience. The SEC indicates its concern that, in the absence of the second exception, the use of U.S. agents by non-U.S. persons might be curtailed. However, as noted above, the second exception from the mandatory clearing and trade execution requirements would not be applicable where one of the non-U.S. counterparties is an SBSD.

VIII. SUBSTITUTED COMPLIANCE

A. SUBSTITUTED COMPLIANCE

The Proposed Rules provide that if the Title VII regime applies to a particular SBS transaction, the parties to the SBS may be able to satisfy certain of their obligations under U.S. law with respect to that transaction through “substituted compliance” — that is, by complying with applicable regulatory...
requirements imposed by a foreign country that the SEC determines to be comparable with the Title VII regime.

A person relying on substituted compliance would still be subject to the applicable U.S. regulatory requirement, but could comply with that requirement in an alternative fashion by complying with the corresponding foreign regulation. The person’s failure to comply with the applicable non-U.S. regulatory requirement would result in a violation of the U.S. requirement, in addition to whatever consequences result under the non-U.S. regulatory regime.

For the purpose of making substituted compliance determinations, the SEC proposes to divide the Title VII requirements into the following four categories:

- entity-level and transaction-level requirements under Section 15F of the Exchange Act applicable to registered non-U.S. SBSDs;
- requirements relating to regulatory reporting and public dissemination of SBS transaction data;
- requirements relating to mandatory clearing for SBS transactions; and
- requirements relating to mandatory trade execution for SBS transactions.73

1. The SEC’s Proposed Approach to Substituted Compliance Determinations

In determining whether a particular non-U.S. regulatory regime is comparable to Title VII, the SEC would make determinations on a category-by-category basis and proposes to permit substituted compliance in one or more categories, without necessarily allowing it in others. The SEC also states that in light of the SEC’s responsibility to implement the specific provisions of Title VII, it does not propose to make substituted compliance determinations on a regime-wide basis. Nor, however, would the SEC base its decision on a rule-by-rule comparison. Instead, the SEC would apply a holistic approach focusing on the comparability of regulatory outcomes. Among other factors, the SEC would consider the effectiveness of the supervisory compliance program administered and the enforcement authority exercised by the non-U.S. regulatory authority.74 The SEC could also condition its substituted compliance determinations as it deems appropriate.

Once a substituted compliance determination has been made with respect to a regulatory requirement, the Proposed Rules would permit the SEC to modify or withdraw the determination after “appropriate” notice and opportunity for comment.75 The Proposed Rules do not specify a minimum notice period before a determination could be modified or withdrawn.

2. The Process for Substituted Compliance Determinations

The Proposed Rules would establish new procedures for the submission of requests for comparability determinations that are similar to the SEC’s existing procedures for the consideration of exemptive order applications under Section 36 of the Exchange Act. The SEC would not consider hypothetical or anonymous requests.76
An application for a substituted compliance determination would be required to contain, among other things, information regarding applicable requirements established by the foreign regulatory authority and the methods used by the foreign regulatory authority to enforce and monitor compliance with such requirements. Upon submission, an application would be reviewed by the SEC’s Division of Trading and Markets, which would then make a recommendation to the SEC. As part of its deliberations, the SEC could, at its discretion, publish a notice in the Federal Register inviting comment on the requested action, or schedule a hearing on the matter addressed by the application. The SEC expects that the process of making a comparability determination would include consultation with relevant non-U.S. regulatory authorities.

3. Determinations Regarding Entity-Level and Transaction-Level Requirements Applicable to non-U.S. SBSDs

The entity-level and transaction-level requirements applicable to registered non-U.S. SBSDs specified in Section 15F of the Exchange Act (and the rules and regulations thereunder) comprise one category of rules that could become the subject of a substituted compliance determination. In order to make such a determination, the SEC would be required to determine that the requirements applicable to non-U.S. SBSDs under the foreign regulatory system are comparable to the entity-level or transaction-level requirements in question. This determination would be based on “such factors as the SEC considers appropriate, such as the scope and objectives of the relevant foreign regulatory requirements, as well as the effectiveness of the supervisory compliance program administered, and the enforcement authority exercised” by the relevant foreign regulatory authority. In addition, before making a substituted compliance determination, the SEC would be required to have entered into a supervisory and enforcement memorandum of understanding with the relevant foreign regulator addressing oversight and supervision of the SBSDs subject to the determination.

Under the Proposed Rules, the SEC would have the power to make substituted compliance determinations with respect to some but not all the specified entity-level or transaction-level requirements. In general, however, the SEC intends to make substituted compliance determinations for the entire group of related requirements.

Substituted compliance determinations would be made on a class or jurisdiction basis (and not on a firm-by-firm basis). Once made, a substituted compliance determination would apply to every non-U.S. SBSD in the specified class or classes registered and regulated in the specified jurisdiction. However, because substituted compliance determinations would not provide for substituted compliance with respect to the SBSD registration requirements of the Exchange Act, even SBSDs relying on a substituted compliance determination would be required to register with the SEC.

The Proposing Release notes that, based on the statutory division of authority with respect to banks in the United States, the SEC is not responsible for the regulation of capital and margin for bank SBSDs and...
therefore does not have the authority to make substituted compliance determinations on capital or margin requirements for bank SBSDs.

4. Determinations Regarding Regulatory Reporting and Public Dissemination

As proposed by the November 2010 Proposal, Regulation SBSR would not have permitted the reporting and public dissemination requirements associated with cross-border SBS transactions to be satisfied through substituted compliance. However, in response to comments, the Proposed Rules contemplate that the SEC could, conditionally or unconditionally, make a substituted compliance determination with respect to such requirements implemented by a foreign jurisdiction in the future. Substituted compliance would only be permitted if:

- at least one of the direct counterparties to the SBS is either a non-U.S. person or a Foreign Branch; and
- no person within the United States is directly involved in executing, soliciting, or negotiating the terms of the SBS transaction on behalf of that direct counterparty. \(^{84}\)

The SEC believes that this approach would promote access by Foreign Branches to non-U.S. markets.

Under the Proposed Rules, certain kinds of SBS transactions would not be eligible for substituted compliance, even if they are reported and publicly disseminated in a foreign jurisdiction. For example, an SBS transaction between two U.S. persons would not be eligible for substituted compliance with respect to reporting and public dissemination requirements, even if the transaction were solicited, negotiated and executed outside the United States.

Similarly, substituted compliance would not be permitted for regulatory reporting and public dissemination requirements where both direct counterparties (or their agents) solicit, negotiate or execute an SBS transaction within the United States. As noted elsewhere, however, counterparties seeking substituted compliance determinations for SBS transactions conducted outside the United States may require further clarification from the SEC on the extent to which the involvement by third parties, agents, affiliates or other personnel located within the United States would constitute “direct involvement” in the solicitation, negotiation or execution of an SBS transaction.

The Proposing Release also indicates that in making its substituted compliance determination, the SEC would take into account such factors as it deems appropriate, such as the scope and objectives of the foreign regulatory system and the effectiveness of the relevant supervisory compliance program and enforcement authority. In addition, the SEC would not make a substituted compliance determination with respect to regulatory reporting and public dissemination requirements unless it found that:

- the data elements that are required to be reported pursuant to the rules of the relevant foreign jurisdiction are comparable to those required to be reported under Regulation SBSR;
the foreign jurisdiction requires an SBS transaction to be reported and publicly disseminated in a manner and timeframe comparable to those required under Regulation SBSR;

- the SEC has direct electronic access to the SBS data held by the trade repository or foreign regulatory authority to which SBS transactions are reported under the applicable foreign regulations (or, alternatively, a satisfactory information sharing agreement exists); and

- any trade repository or foreign regulatory authority in the foreign jurisdiction that receives and maintains reports of SBS transactions is subject to requirements regarding data collection and maintenance, systems capacity, resiliency and security and recordkeeping comparable to the requirements imposed on SDRs under the Exchange Act.\(^85\)

5. Determinations Regarding Mandatory Clearing Requirements

In the Proposing Release, the SEC states that it would exempt persons from the mandatory clearing requirement with respect to an SBS transaction submitted to a foreign clearing agency that is the subject of a substituted compliance determination by the SEC. The Proposing Release does not, however, include a specific rule regarding substituted compliance with the mandatory clearing requirement under Title VII. This omission is due, in part, to the SEC’s expectation that there are likely to be a relatively small number of requests for substituted compliance in this area given the small number of SBS clearing agencies, and in part because the clearing agency registration regime already provides for a category of exempt SBS clearing agencies through which market participants may clear their transactions and satisfy the mandatory clearing requirement.

The Proposing Release indicates that requests for substituted compliance determinations would be initiated by the relevant foreign clearing agency. The SEC would only make substituted compliance determinations for clearing agencies that have no members that are U.S. persons and conduct no activities within the United States.\(^86\) The application for a substituted compliance determination would be required to include “sufficiently comprehensive information regarding the clearing agency and the [applicable foreign regulatory regime] such that the SEC has an adequate basis to make the substituted compliance determination.”\(^87\) The SEC expects that its review would include seeking assurances from the foreign clearing agency regarding the absence of members that are U.S. persons and relevant activity in the United States, including the volume of clearing activity originating in the United States. In addition, the SEC’s review would consider the scope and objectives of the applicable foreign jurisdiction’s regulatory requirements, the effectiveness of the applicable supervisory compliance program administered, and the enforcement authority exercised by the relevant foreign regulator to support the oversight of such clearing agency.

6. Determinations Regarding Mandatory Trade Execution Requirements

Under the Proposed Rules, the SEC would permit substituted compliance for Title VII’s trade execution requirements by allowing market participants to execute SBS transactions on a specified non-U.S. SBS market (or class of markets) that the SEC determines to be subject to comparable, comprehensive supervision and regulation by the relevant foreign financial regulatory authority.
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Substituted compliance in this area would only be permitted for SBS transactions where both the following conditions apply to at least one counterparty:

- the counterparty is either a non-U.S. person or a Foreign Branch; and
- the SBS is not solicited, negotiated, or executed by a person within the United States on behalf of that counterparty.\textsuperscript{88}

In making its substituted compliance determination, the SEC would consider such factors as it deems appropriate, “such as the scope and objectives of the applicable foreign jurisdiction’s regulatory requirements, as well as the effectiveness of the supervisory compliance program administered, and the enforcement authority exercised” by the relevant foreign regulator.\textsuperscript{89} The SEC believes that the factors it could consider in assessing the effectiveness of foreign supervisory compliance may include the existence of a dedicated examination program, examiners with proper expertise, the existence of a risk monitoring framework and an examination plan, and a disciplinary program to enforce compliance.\textsuperscript{90}

The Proposed Rules provide that one or more SBS markets could initiate the process of making a substituted compliance determination. Before making a substituted compliance determination, the SEC would be required to have entered into a supervisory and enforcement memorandum of understanding with the relevant foreign financial regulatory authority addressing the oversight and supervision of the SBS market (or class of markets) subject to the determination.

IX. PROPOSED RULES ON SBS CLEARING AGENCIES, SDRS AND SBS EXECUTION FACILITIES

A. SBS CLEARING AGENCIES AND CROSS-BORDER SBS TRANSACTIONS

Section 17A(g) of the Exchange Act requires any clearing agency which uses the means or instrumentalities of inter-state commerce to clear SBS transactions to register with the SEC.\textsuperscript{91} Although clearing agencies perform a number of functions, the Proposing Release only provides guidance regarding the registration requirement for clearing agencies that provide central counterparty services, which we refer to as “CCPs” in this memorandum. When a CCP clears an SBS transaction between two transaction counterparties, it interposes itself between the counterparties, thus replacing the original SBS contract with two new, separate contracts between the CCP on the one hand and each of the two counterparties on the other hand. Thus, a CCP effectively assumes the counterparty credit risk of each of the original counterparties.

The SEC has already provided a temporary exemption from registration requirements for clearing agencies which provide non-CCP types of clearance and settlement services for SBS transactions\textsuperscript{92} and expects to provide further guidance for such non-CCP clearing agencies in a future release.\textsuperscript{93}
1. Registration Requirements for Clearing Agencies Providing CCP Services

According to the Proposing Release, the registration requirement with respect to CCPs would apply to any clearing agency that functions as a CCP within the United States, regardless of the CCP’s principal place of business or place of incorporation or organization. For this purpose, a CCP would function within the United States if it cleared SBS transactions for a member that is a U.S. person.

In support of this proposed approach, the SEC notes that CCPs perform a “risk mutualization” function through loss-sharing arrangements among their members. Accordingly, where a non-U.S. CCP clears transactions for a U.S. member, such risk mutualization arrangements may, in the SEC’s view, spread the risk of a non-U.S. person’s losses among U.S. persons, thus posing a risk to the financial stability of the United States. This risk, according to the SEC, justifies the extension of the registration requirement to any CCP that clears transactions for a member that is a U.S. person.

By contrast, the SEC’s interpretive guidance in the Proposing Release clarifies that registration is not required where a U.S. person seeks to clear an SBS transaction indirectly through a non-U.S. CCP by the use of a correspondent clearing arrangement with a non-U.S. member of such non-U.S. CCP. The SEC believes correspondent clearing arrangements of this type do not pose direct risks to the U.S. financial system because a CCP’s risk mutualization arrangements are limited to its members and do not extend to customers of its members.

2. Exemption from Clearing Agencies’ Registration Requirements

The Proposing Release indicates that the SEC may grant a conditional or unconditional exemption from clearing agency registration requirements applicable to a non-U.S. CCP if the SEC finds that the CCP is also subject to comparable, comprehensive supervision and regulation by the CFTC or by appropriate government authorities in its home jurisdiction.

The SEC indicates, however, that at this time it will not specify how a substituted compliance determination might be made for clearing agency registration requirements applicable to a non-U.S. CCP. The Proposing Release notes that future determinations on substituted compliance for clearing agency registration requirements applicable to a non-U.S. CCP are likely to be affected by certain factors that vary across jurisdictions, such as market structure and clearing agency supervision as well as by factors which vary across organizations, such as organizational governance, membership rules and risk management procedures.94

As an alternative to exempting CCPs from clearing agency registration requirements, the SEC may consider proposing rules that are specific to registered non-U.S. CCPs. According to the SEC, the Exchange Act permits the SEC to use this alternative in order to conform to evolving U.S. and international regulatory standards. The SEC believes this alternative may be particularly appropriate for -28-
where the need to be consistent with certain specific regulatory standards justifies the use of a targeted regulatory approach instead of a general exemption.\textsuperscript{95}

**B. SBS DATA REPOSITORIES**

1. **Application of SBSDR Requirements in the Cross-Border Context**

Title VII authorizes the SEC to adopt rules for the registration of SBSDRs, which it defines as "any person that collects or maintains information or records with respect to transactions or positions in, or the terms and conditions of, security-based swaps entered into by third parties for the purpose of providing a centralized recordkeeping facility for security-based swaps."\textsuperscript{96} SBSDRs play a key role in enhancing transparency in the SBS market by retaining complete and accurate records of SBS transactions. The SEC has previously proposed rules governing SBSDRs, including rules relating to the registration process, data maintenance, privacy and disclosure requirements and core principles governing access to SBSDR-held data by relevant authorities (together, the "SBSDR Requirements").\textsuperscript{97} The Proposing Release discusses the extent to which the SBSDR Requirements would apply in the cross-border context.

According to the Proposing Release, the SBSDR Requirements would be applicable to any U.S. person that performs SBSDR functions, as well as any non-U.S. person that performs SBSDR functions in the United States. Pursuant to interpretive guidance proposed in the Proposing Release, a non-U.S. person performs the functions of an SBSDR within the United States if, for example, (i) it enters into contracts with a U.S. person to enable the U.S. person to report SBS data to such non-U.S. person, or (ii) it has operations in the United States, such as maintaining SBS data on servers physically located in the United States, even if its principal place of business is not in the United States. Noting that the SBS market is subject to constant innovation and that this determination is necessarily a fact-intensive one, the SEC, in the Proposing Release, declines to provide a comprehensive list of activities that would amount to the performance of the functions of an SBSDR within the United States by a non-U.S. person.

Under the Proposed Rules, a non-U.S. person that performs the functions of an SBSDR within the United States would not be subject to the SBSDR Requirements, provided that each regulator with supervisory authority over the non-U.S. person had entered into a supervisory and enforcement memorandum of understanding or other arrangement with the SEC that addresses the confidentiality of data collected by such non-U.S. SBSDR, the SEC’s access to the data and any other matters determined by the SEC (the “SBSDR Exemption”).\textsuperscript{98} According to the SEC, the SBSDR Exemption is necessary to balance the SEC’s interest in having access to SBS data involving U.S. persons against concerns regarding duplicative or conflicting foreign regulatory requirements.

The SEC indicates that it would consider a number of factors in deciding whether to enter into a supervisory and enforcement memorandum of understanding or other arrangement with another regulator for the purposes of the SBSDR Exemption. Specifically, the SEC anticipates that it would consider whether (i) the other regulator would maintain the confidentiality of SBS data collected and maintained by
the non-U.S. person that performs the functions of an SBSDR within the United States, (ii) the SEC would have access to SBS data collected and maintained by the non-U.S. person, (iii) the other regulator would provide the SEC with reciprocal assistance in securities matters within the SEC’s jurisdiction, and (iv) the memorandum of understanding or arrangement would be in the public interest.  

2. Access to SBS Data held by SBSDRs

Section 13(n)(5)(G) of the Exchange Act and proposed rule 13n-4(b)(9) require an SBSDR to provide, upon request and on a confidential basis, all SBS data obtained by the SBSDR (including individual counterparty trade and position data), to each appropriate prudential regulator, the Financial Stability Oversight Council, the CFTC, the Department of Justice, the Federal Deposit Insurance Corporation and any other person that the SEC determines to be appropriate (including, where determined by the SEC, foreign governments and other authorities). However, before the SBSDR can share SBS data with any such entity, the following conditions must be satisfied:

- the SBSDR must notify the SEC of the request for such data (the “Notification Requirement”);
- the SBSDR must obtain a written agreement from the authority or other entity receiving the data, in which the authority or other entity agrees to abide by certain confidentiality requirements; and
- the authority or other entity receiving the data must agree to indemnify the SBSDR and the SEC for any expenses arising from litigation relating to the unlawful disclosure of the data so provided (the “Indemnification Requirement”).

a. The Notification Requirement

In its interpretive guidance included in the Proposing Release, the SEC indicates that once the SBSDR has notified the SEC of an authority’s initial request for SBS data, the SBSDR would not be required to separately notify the SEC of every subsequent request from that authority. Instead, the SEC proposes that a more efficient solution would be to require the SBSDR to maintain records of the initial request and all subsequent requests in satisfaction of the Notification Requirement. The SBSDR would be required to maintain the confidentiality of any requests for SBS data and of any notifications of such requests to the SEC.

b. Requests to Access SBS Data

The Proposing Release indicates that a foreign or domestic authority may request the SEC to make a determination permitting the authority to request SBS data from an SBSDR. The SEC expects that it will consider a number of factors in making this determination, including whether the authority has a legitimate need for the SBS data and, relatedly, the regulatory mandate and responsibilities of the requesting authority. The SEC also states that its determination as to whether an authority may request SBS data from an SBSDR will likely be conditioned on a supervisory or enforcement memorandum or other arrangement between the SEC and such authority that would maintain the confidentiality of the information sought by the authority.
Notably, however, the SEC also states that even where the SEC makes a determination permitting an authority to seek SBS data from an SBSDR, the SBSDR would still have the discretion to decide whether to provide such authority with the specific SBS data requested. Accordingly, in order to maintain the flexibility of SBSDRs to determine which requests to grant, the SEC in the Proposing Release declines to provide specific criteria for requesting authorities and SBSDRs to use in facilitating access to SBS data.

c. The Indemnification Requirement

In the Proposing Release, the SEC acknowledges concerns raised by a number of commenters that the Indemnification Requirement contravenes the purposes of Dodd-Frank as well as the statutory purpose of SBSDRs as entities which can provide enforcement authorities with certain kinds of trading and counterparty-specific information. The SEC recognizes that many domestic and foreign authorities (including the SEC itself) are not permitted by their applicable laws to provide an SBSDR with an open-ended indemnification agreement. The SEC also notes that a number of foreign authorities have indicated that an open-ended indemnification requirement might result in the fragmentation of SBS data across multiple SBSDRs, as foreign authorities would establish trade repositories in their respective jurisdictions to ensure access to data needed to perform their specific regulatory responsibilities.

In response to these concerns, the SEC preliminarily proposes that an SBSDR would not be required to comply with the Indemnification Requirement (the “Indemnification Exemption”) if:

- an authority requests SBS data from the SBSDR to fulfill its regulatory mandate and/or legal responsibilities;
- the authority’s request pertains to a person or financial product subject to the jurisdiction, supervision or oversight of the authority; and
- the authority has entered into a supervisory or enforcement memorandum of understanding or other arrangement with the SEC that addresses the confidentiality of the SBS data provided, and any other matters determined by the SEC.

With reference to the third requirement under the Indemnification Exemption, the SEC indicates that its decision to enter into a memorandum of understanding or other arrangement with an authority requesting SBS data, will, among other things, depend on whether (i) the relevant authority needs such data to fulfill its regulatory mandate or legal responsibilities, (ii) the relevant authority agrees to protect the confidentiality of the SBS data provided, (iii) the relevant authority agrees to provide the SEC with reciprocal assistance in securities matters within the SEC’s jurisdiction, and (iv) such a memorandum of understanding or arrangement would be in the public interest. The SEC also believes that where an authority seeking SBS data cannot agree to indemnification, a memorandum of understanding or other arrangement entered into pursuant to the Indemnification Exemption will serve as a mechanism to protect the confidentiality of any SBS data provided to the requesting authority.

The SEC notes that the Indemnification Exemption is intended to preserve cooperation among regulators around the world and that the Indemnification Exemption will be available to both domestic and foreign
The SEC also points out that an SBSDR would have the option of either seeking indemnification under the Indemnification Requirement or relying on the Indemnification Exemption. However, the SEC has declined to provide model indemnification language because such language could vary based on a number of factors such as the laws applicable to the relevant authority.

C. SBS EXECUTION FACILITIES

Section 3D(A)(1) of the Exchange Act requires that any facility for the trading or processing of SBS transactions must be registered as either an SBS execution facility (an “SBSEF”) or as a national securities exchange. Although the SEC has previously proposed rules for SBSEFs in proposed Regulation SB SEF, those proposed rules do not explicitly address the circumstances under which a non-U.S. SBSEF would be required to register with the SEC or the circumstances under which the SEC would provide an exemption from such registration. The Proposing Release addresses these questions.

1. The Registration Requirement for Non-U.S. SBS Markets

The SEC believes that in determining whether a non-U.S. SBS market would be required to register as an SBSEF, relevant considerations include (i) the activities by the non-U.S. SBS market that provide U.S. persons, or non-U.S. persons located in the United States, with the ability to directly execute or trade SBS transactions and (ii) the affirmative actions of the non-U.S. person to induce the execution or trading on its market by U.S. persons, or by non-U.S. persons located in the United States.

a. Inducing Execution or Trading on a Non-U.S. SBS Market

Under the SEC’s proposal, where a non-U.S. SBS market (i) markets its services relating to the ability to execute or trade SBS transactions on such non-U.S. market to U.S. persons or to non-U.S. persons located in the United States, or (ii) initiates contact with a U.S. person or a non-U.S. person located in the United States, such marketing activity or initiation of contact would result in the non-U.S. SBS market being required to register as an SBSEF.

In the Proposing Release, the SEC discusses some of the types of activities that it believes would result in a non-U.S. SBS market being required to register as an SBSEF. These activities include the following:

- providing proprietary electronic screens, marketing terminals, monitors or other devices for SBS trading on the non-U.S. SBS market;
- granting direct electronic access to the non-U.S. SBS market’s trading system or network, including by providing data feeds or codes for use with software operated through the computer of a U.S. person or a non-U.S. person located in the United States;
- allowing the members of, or participants in, the non-U.S. SBS market to provide U.S. persons or non-U.S. persons located in the United States with direct electronic access to SBS trading on the non-U.S. SBS market; and
- granting membership or participation in the non-U.S. SBS market to U.S. persons or to non-U.S. persons located in the United States in a manner that would allow such persons to directly execute or trade SBSs by accepting bids and offers on the non-U.S. SBS market.
Noting the constant innovation in trading mechanisms and methods on SBS markets, however, the SEC indicates that its discussion in the Proposing Release is neither comprehensive nor final.

The Proposing Release also addresses situations where U.S. persons or non-U.S. persons located in the United States choose to transact on a non-U.S. SBS market indirectly — that is, through a non-U.S. person located outside the United States who is a member of, or a participant in, a non-U.S. SBS market. The SEC believes that if a U.S. person, or a non-U.S. person located in the United States, initiated such a transaction and the non-U.S. SBS market did not solicit it, then the non-U.S. SBS market would not be required to register as an SBSEF as a result of the transaction. However, if the non-U.S. SBS market initiated contact in the United States with a U.S. person in order to induce or facilitate SBS trading on its market, the registration requirement would be triggered.\(^{116}\)

b. Business Combinations between a Registered SBSEF and a Non-U.S. SBS Market

Based on several recent market developments, the SEC also notes the possibility that there may be future business combinations involving registered SBSEFs and non-U.S. SBS markets. In the SEC’s view, such a business combination would trigger the SBSEF registration requirement if the entities’ operations and activities are integrated to the point where the non-U.S. SBS market could provide direct access to the registered SBSEF’s participants, or if the two entities were to integrate their liquidity or trading pools. By contrast, where the two entities continue to operate as separate legal entities, maintain separate liquidity and trading pools and continue to be separately regulated in their home jurisdictions, the non-U.S. SBS market would not be subject to the registration requirement.\(^ {117}\)

2. Substituted Compliance and the Registration Exemption for Non-U.S. SBS Markets

The SEC acknowledges that it has received a number of comments regarding the possibility of non-U.S. SBS markets being subject to duplicative or conflicting regulatory requirements. Accordingly, the SEC proposes to permit substituted compliance with the SBSEF registration requirement by exempting from the registration requirement any non-U.S. SBS market that is subject to comparable, comprehensive supervision and regulation in its home jurisdiction.\(^ {118}\)

In determining whether a non-U.S. SBS market is subject to comparable, comprehensive supervision and regulation in its home jurisdiction, the SEC anticipates that it will review the applicable foreign laws, rules and regulations and will consult or cooperate with the non-U.S. SBS market’s home country’s governmental authorities. Any relief from the registration requirement could also be made subject to a number of conditions, such as requiring the non-U.S. SBS market to provide the SEC with prompt access to its books and records or requiring the non-U.S. SBS market to appoint a process agent within the United States. Where the regulatory regime in the non-U.S. SBS market’s home jurisdiction is not broadly comparable, the SEC could also require the non-U.S. SBS market to meet some of the requirements applicable to registered SBSEFs.\(^ {119}\)
Public comments on the Proposed Rules are due by August 21, 2013.

While the SEC acknowledges that the markets, market participants and products regulated by the SEC and the CFTC differ, the SEC nevertheless states that the regulators are guided by the objective of establishing consistent and comparable requirements for U.S. market participants. The SEC therefore invites comments on differences between the two regulators’ approaches to the application of Title VII to cross-border activities and on whether the SEC’s proposed application of Title VII should be modified to conform to the CFTC’s proposed approach.

The SEC also reopened, until July 22, 2013, the comment period for all pending rules relating to Title VII that are not yet final. This comment period also applies to the related SEC policy statement describing the order in which these rules are expected to become effective.

The pending rules reopened for comment are:

- Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps under Regulation MC;\(^{120}\)
- Prohibition Against Fraud, Manipulation, and Deception in Connection with Security-Based Swaps;\(^{121}\)
- Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information;\(^{122}\)
- Security-Based Swap Data Repository Registration, Duties, and Core Principles;\(^{123}\)
- End-User Exception to Mandatory Clearing of Security-Based Swaps;\(^{124}\)
- Registration and Regulation of Security-Based Swap Execution Facilities;\(^{125}\)
- Trade Acknowledgement and Verification of Security-Based Swap Transactions;\(^{126}\)
- Clearing Agency Standards for Operation and Governance;\(^{127}\)
- Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants;\(^{128}\)
- Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers.\(^{130}\)

* * *

An SBS transaction to which a specified international organization is a party may not, however, benefit fully from the relief intended by the “U.S. person” exclusion, unless activities by the organization are also deemed not to be “transactions conducted within the United States” (as further discussed in Section II.B of this memorandum).

Note, however, that if one or both of such non-U.S. persons utilized financial or legal advisers located within the United States in connection with the negotiation or execution of the SBS transaction, the Proposed Rules appear to indicate that the SEC might consider the transaction to have been conducted within the United States and may therefore require the transaction to be counted in calculating the *de minimis* amount.

A person that exceeds the *de minimis* amount is not required to register as an SBSD until the end of the second month after the relevant threshold is reached. However, that person’s SBS transactions cannot be excluded under the proposed operationally independent SBSD exclusion unless that person is a registered SBSD at the time that the relevant calculation is required to be made. Accordingly, unless the person that exceeds the *de minimis* amount registers prior to its registration deadline, its...
transactions may need to be included in the relevant aggregation pool, with potential registration
being then required for all affiliates in such aggregation pool. It is not clear that the SEC intended
this outcome and further clarification may be required on this issue.

17 CFR § 240.3a71-4.

78 FR 31005.

See 78 FR 41219-20. Note, however, that the CFTC’s proposed cross-border guidance would
permit non-U.S. persons engaged in dealing activity with U.S. persons to aggregate the dealing
positions of their non-U.S. affiliates separately from the dealing positions of their U.S. affiliates.

77 FR 41213.

See 78 FR 41219-20.

See “Final Exemptive Order Regarding Compliance With Certain Swap Regulations,” 78 FR 858,
867-68 (Jan. 7, 2013).

For more information with respect to the SEC’s proposed external business conduct rules, see
our Memorandum to Clients, dated July 8, 2011, entitled “SEC Issues Proposed Rules Regarding
Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap
Participants.”

17 CFR § 240.3a67-10(b).

See 17 CFR § 240.3a71-3(a)(2).

See 17 CFR § 240.3a71-3(a)(6). Although a transaction with an international organization that is
excluded from the “U.S. person” definition initially may seem to be outside of a non-U.S. SBSD’s
U.S. Business, such a transaction would become part of the SBSD’s U.S. Business if the
transaction is negotiated or executed within the United States – including at any office of the
international organization that may be located in the United States. By contrast, under Regulation
S, offers and sales of securities made to persons excluded from the definition of “U.S. person,”
even if physically present in the United States, are deemed to have been made outside the
United States.

See 17 CFR § 240.3a71-3(a)(6). As discussed further below, the Proposed Rules are not entirely
clear on the level of involvement by U.S. persons permitted where a transaction is conducted
through a Foreign Branch. This, and similar ambiguities relating to the definition of a “transaction
conducted within the United States,” may make it difficult for SBSDs to clearly determine the
scope of the term “U.S. Business.”

As noted in Section II.B.4, an SBS transaction will only be considered a “transaction conducted
through a Foreign Branch” if no person within the United States is directly involved in soliciting,
negotiating, or executing the transaction on behalf of the Foreign Branch or its counterparty. This
may pose logistical challenges for U.S. persons trying to execute transactions through a Foreign
Branch, where the Foreign Branch or its counterparty wishes to use the services of U.S.-based
financial advisers, investment managers, legal counsel or other agents or associates in
connection with the soliciting, negotiation or execution of the transaction. Further clarification
from the SEC may be necessary on the extent to which U.S. persons may be involved in the
soliciting, negotiation or execution of a transaction on behalf of a Foreign Branch without
rendering the transaction “conducted within the United States.”

78 FR 31017.

See generally 17 CFR § 240.18a-4.


17 CFR § 240.18a-4(e)(1)(ii).
37 17 CFR § 240.18a-4(e)(2)(i).
38 17 CFR § 240.18a-4(e)(2)(iii).
39 17 CFR § 240.18a-4(e)(2)(ii).
40 17 CFR § 240.18a-4(e)(3).
41 78 FR 31024.
42 17 CFR § 240.3a67-10(c)(1).
43 17 CFR § 240.3a67-10(c)(2).
44 78 FR 31030.
45 78 FR 31031.
46 17 CFR § 240.3a67-3(e).
47 78 FR 31032.
48 78 FR 31032-33.
49 78 FR 31033.
50 78 FR 31034.
51 *Id.*
52 *See* 17 CFR § 240.3a67-10(b) and 17 CFR § 240.18a-4(f).
53 17 CFR § 240.18a-4(f).
54 78 FR 31035.
55 *Id.*
56 For more information regarding the November 2010 Proposal, *see our Memorandum to Clients, dated December 1, 2010, entitled “SEC Proposes Regulation SBSR regarding Reporting and Dissemination of Security-Based Swap Information.”*
57 17 CFR § 242.900(pp).
60 78 FR 31063.
61 17 CFR § 242.908(b).
63 17 CFR § 242.901(a).
64 78 FR 31070.
65 78 FR 31073.
66 78 FR 31074.
67 *See* 17 CFR § 240.3Ca-3(a) and 17 CFR § 240.3Ch-1(a). The Proposing Release considers the mandatory clearing and trade execution requirements to be complementary so that the trade execution requirement would apply to each SBS transaction that is subject to the clearing requirement. It is also possible, however, that SBS transactions that have been designated for clearing by the SEC but that have not been accepted for clearing by clearing agencies, may nevertheless be subject to the trade execution requirement.
See 17 CFR § 240.3Ca-3(a)(1) and 17 CFR § 240.3Ch-1(a)(1).

Note that the phrase “transaction conducted within the United States” addresses the elements discussed in Section II.B above, as they relate to the SBS transaction itself (rather than a guarantee with respect thereto).

See 17 CFR § 240.3Ca-3(b) and 17 CFR § 240.3Ch-1(b).

78 FR 31079.

78 FR 31084.

78 FR 31085.

78 FR 31088.

See, e.g., 17 CFR § 240.3a71-5(a)(4) or 17 CFR § 240.3Ch-2(a)(4).

17 CFR § 240.0-13(e).

Id.

17 CFR § 240.0-13(h)-(i).

17 CFR § 240.3a71-5(a)(2)(i).

17 CFR § 240.3a71-5(a)(2)(ii).

78 FR 31088.

17 CFR § 240.3a71-5(a).

17 CFR § 240.3a71-5(a)(3).

17 CFR § 242.908(c)(1).


78 FR 31098.

Id.

17 CFR § 240.3Ch-2(a)(1) and (2). A counterparty seeking to rely on such substituted compliance may need to ensure that no adviser, legal counsel or other agent located within the United States is involved in the solicitation, negotiation or execution of such SBS transaction on its behalf.

17 CFR § 240.3Ch-2(b)(2).

78 FR 31100.

Section 3(a)(23)(A) of the Exchange Act defines the term “clearing agency” to mean any person who: (i) acts as an intermediary in making payments or deliveries or both in connection with transactions in securities; (ii) provides facilities for comparison of data respecting the terms of settlement of securities transactions, to reduce the number of settlements of securities transactions, or for the allocation of securities settlement responsibilities; (iii) acts as a custodian of securities in connection with a system for the central handling of securities whereby all securities of a particular class or series of any issuer deposited within the system are treated as fungible and may be transferred, loaned, or pledged by bookkeeping entry, without physical delivery of securities certificates (such as a securities depository); or (iv) otherwise permits or facilitates the settlement of securities transactions or the hypothecation or lending of securities without the physical delivery of securities certificates (such as a securities depository). See 15 U.S.C. 78c(a)(23)(A).

See “Order Pursuant to Section 36 of the Securities Exchange Act of 1934 Granting Temporary Exemptions from Clearing Agency Registration Requirements under Section 17A(b) of the

93 78 FR 31037, n.666.
94 78 FR 31039.
95 Id.
97 Specifically, the Proposing Release defines SBSDR Requirements to refer to the provisions of Section 13(n) of the Exchange Act and proposed rules 13n-1 to 13n-11 thereunder. See “Security-Based Swap Data Repository Registration, Duties, and Core Principles,” 75 FR 77306 (Dec. 10, 2010).
98 17 CFR § 240.13n-12(b).
99 78 FR 31043.
101 78 FR 31047, n.778.
102 78 FR 31047.
103 Id.
104 78 FR 31048, n.790.
105 17 CFR § 240.13n-4(d).
106 The SEC has, however, clarified that the person or financial product does not have to be registered or licensed with the authority in order for this condition to be satisfied. See 78 FR 31050.
107 78 FR 31051.
108 78 FR 31049.
109 78 FR 31051.
110 Id.
111 The Exchange Act defines an SBSEF as a “trading system or platform in which multiple participants have the ability to execute or trade security-based swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that (A) facilitates the execution of security-based swaps between persons and (B) is not a national securities exchange.” See 15 U.S.C. 78c(a)(77).
112 See “Registration and Regulation of Security-Based Swap Execution Facilities” (Feb. 29, 2011). For more information regarding this release, see our Memorandum to Clients, dated March 21, 2011, entitled “SEC Proposes Rules on Registration of Security-Based Swap Execution Facilities.”
113 78 FR 31054.
114 Id.
115 Id.
116 78 FR 31055.
117 Id.
118 78 FR 31056.
ENDNOTES (Continued)

119  *Id.*


121  *See our Memorandum to Clients, dated Nov. 9, 2010, entitled “SEC Issues Proposed Rule Prohibiting Fraud, Manipulation and Deception in Connection with Security-Based Swaps.”*

122  *See our Memorandum to Clients, dated Dec. 1, 2010, entitled “SEC Proposes Regulation SBSR regarding Reporting and Dissemination of Security-Based Swap Information.”*

123  75 FR 77306 (Dec. 10, 2010).

124  75 FR 79992 (Dec. 21, 2010)

125  *See our Memorandum to Clients, dated March 21, 2011, entitled “Security-Based Swap Execution Facilities: SEC Proposes Rules on Registration of Security-Based Swap Execution Facilities.”*

126  *See our Memorandum to Clients, dated Jan. 19, 2011, entitled “SEC Proposes to Require Security-Based Swap Dealers and Major Security-Based Swap Participants to Provide and Verify Trade Acknowledgments in Security-Based Swap Transactions.”*

127  *See our Memorandum to Clients, dated Nov. 28, 2012, entitled “SEC Adopts Rule Establishing Minimum Requirements for Registered Central Counterparties and Central Security Depositories.”*

128  *See our Memorandum to Clients, dated October 18, 2011, entitled “Registration Process for Security-Based Swap Entities: SEC Proposes Rules on Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants.”*


130  *See our Memorandum to Clients, dated Nov. 19, 2012, “SEC Proposes Rules Regarding Capital, Margin and Collateral Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants.”*
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