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Cross-Border Security-Based Swaps

SEC Adopts Initial Final Rules on Cross-Border Security-Based Swap Activities

EXECUTIVE SUMMARY

On June 25, 2014, the Securities and Exchange Commission issued a release with final rules and interpretations on the cross-border application of certain security-based swap provisions under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The rulemaking set forth in the release, which was published in the *Federal Register* on July 9, is the first of what the SEC expects to be a series of rulemakings by the SEC on the cross-border application of the substantive requirements imposed on security-based swap activities by Title VII.

Among other things, the release addresses:

- the definition of "U.S. person" in the context of the cross-border security-based swap regime;
- the application of the cross-border regime to foreign branches, affiliates and subsidiaries of U.S. and non-U.S. persons;
- the impact of guarantees in the cross-border context;
- the treatment of cross-border security-based swap transactions for purposes of the registration obligations of security-based swap dealers and major security-based swap participants;
- the aggregation and attribution rules to be used in determining security-based swap dealer and major security-based swap participant status in the cross-border context;
- the treatment of security-based swap transactions by "conduit affiliates" of U.S. persons;
- procedural requirements for seeking "substituted compliance" by which security-based swap market participants may satisfy certain obligations under Title VII by complying with comparable non-U.S. regulatory regimes; and
- the scope of the SEC's cross-border anti-fraud authority.

Importantly, however, the final rules do not address how Title VII will treat security-based swap transactions between two non-U.S. persons where one or both of the non-U.S. persons conducts dealing activities in the United States. The SEC solicits additional comment on the topic.

The SEC's approach in the final rules differs in certain respects from the approach taken by the Commodity Futures Trading Commission in its analogous final rules for the regulation of cross-border swaps, swap markets, and swap market participants. Annex A describes some of the important differences between the SEC and CFTC approaches.

The final rules will become effective on September 8, 2014.

Table of Contents

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, 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, 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").[1] The Proposing Release reflected the SEC's position that Section 30(c) of the Exchange Act required a "territorial approach". In the context of the global SBS market, the SEC believed that a territorial approach would be one which looked to the full range of activities described in Dodd-Frank as well as the concerns Congress intended Title VII to address, irrespective of the location of the entity engaging in the activity or bearing the risk. The SEC's release of June 25, 2014 (the "Adopting Release") — which deals with a narrower range of issues than the Proposing Release — confirms that the SEC will generally be using this territorial approach in determining the application of the SBSD and MSBSP definitions to cross-border SBS activities.

In the Proposing Release, the SEC estimated that approximately 50 entities would engage in dealing activities that would be significant enough to require SBSD registration and fewer than five entities would

[1] *See* "Cross-Border Security-Based Swap Activities: Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants," (May 1, 2013), 78 FR 30968 (May 23, 2013). For more information regarding the Proposing Release, *see* our Memorandum to Clients, dated June 7, 2013, entitled "SEC Releases Proposed Rules and Guidance on Cross-Border Security-Based Swaps."

engage in security-based swap activities sufficient to require registration as an MSBSP. The SEC in the Adopting Release analyzes additional SBS data and confirms these estimates.

The SEC's approach differs in certain respects from the approach taken by the CFTC in its release providing guidance on the regulation of cross-border swaps, swap markets and swap market participants. A comparison of certain important differences between the SEC's and CFTC's approaches is provided in Annex A hereto.

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

In general, the Proposing Release would have applied the requirements of the Exchange Act that were added by Title VII to all SBS transactions where at least one of the counterparties was a "U.S. person" or that were "transactions conducted within the United States," as those terms were defined in the proposed rules (the "Proposed Rules"). By contrast, the final rules set forth in the Adopting Release (the "Final Rules") do not adopt the concept of "transactions conducted within the United States". The SEC continues to solicit additional comment on when transactions between two non-U.S. persons where one or both of the non-U.S. persons conducts dealing activities in the United States should be subject to Title VII.

A. "U.S. PERSON"

The Final Rules define a "U.S. person", for purposes of the SBS cross-border regulatory regime, as:

- any natural person resident in the United States;
- any partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated or established[2] under the laws of the United States or having its principal place of business in the United States;
- any account (whether discretionary or non-discretionary) of a U.S. person; or
- an estate of a decedent who was a resident of the United States at the time of death.

1. Natural Persons

The SEC indicates in the Adopting Release that residency, and not citizenship, is the key consideration in determining whether a natural person is a U.S. person. Thus, individuals resident abroad are not U.S. persons under the Final Rules, even if they possess U.S. citizenship, while any natural person resident in the United States is a U.S. person regardless of the individual's citizenship status.

[2] The SEC added the word "established" to the final version of the definition of U.S. person in order to clarify its intention that any person formed in any manner under the laws of the United States would be a U.S. person.

2. Independent Determinations With Respect to Legal Entities

The SEC indicates in the Adopting Release that each entity is analyzed separately for purposes of determining whether it is a U.S. person. Accordingly, the Adopting Release states that "the status of a legal person as a U.S. person has no bearing on whether separately incorporated or organized legal persons in its affiliated corporate group are U.S. persons."[3] Thus, a foreign subsidiary of a U.S. person would not be a U.S. person by reason of its U.S. parent and foreign person with a U.S. subsidiary will not be a U.S. person by reason of its relationship with the U.S. subsidiary. This result applies even if the SBS activities of the non-U.S. person are subject to a recourse guaranty of a U.S. person.

3. Principal Place of Business

a. Generally

The U.S. person definition under the Final Rules includes entities that are organized, incorporated or established outside the United States but that have their principal place of business in the United States. The SEC defined U.S. person to include a foreign entity with its principal place of business in the United States in order to ensure that entities did not seek to avoid complying with Title VII by changing their jurisdiction of formation while maintaining their business in the United States.

The Final Rules define "principal place of business", for purposes of the U.S. person definition, as "the location from which the officers, partners, or managers of the legal person primarily direct, control, and coordinate the activities of the legal person." According to the SEC, this definition is intended to identify the location where a significant portion of the person's financial and legal relationships would be likely to exist and would generally (other than for externally managed investment vehicles) correspond to the location of the person's headquarters or main office. Importantly, the SEC indicates in the Adopting Release that the definition does ***not*** look to the location of the persons engaged in SBS activities; this is to prevent an entity from moving its SBS activities outside the United States while maintaining a significant portion of its financial and legal relationships within the United States.

b. Externally Managed Investment Vehicles

The SEC recognized the challenges involved in determining the principal place of business for investment vehicles managed by an external operating company, given that such operating companies typically direct and control the investment vehicle's activities from their offices leaving few or no functions to be carried out by the vehicle itself. The Final Rules provide that an externally managed investment vehicle's principal place of business is the "office from which the manager of the vehicle primarily directs, controls, and coordinates the investment activities of the vehicle." Under this definition, the mere retention of a U.S. asset manager will not result in an offshore investment vehicle being treated as a U.S. person, unless the asset manager, whether or not a U.S. person, is primarily responsible for directing, controlling and

[3] Adopting Release, 79 FR 39098.

coordinating the activities of the investment vehicle and carries out these functions within the United States. Once again, the SEC indicates in the Adopting Release that the definition does ***not*** look to the location of the SBS activity because such an approach would provide an incentive to move SBS activities outside the United States while retaining control of all other activities of the managed vehicle in the United States.

c. No Look-Through for Ownership of Investment Vehicles

In response to comments, the SEC clarifies in the Adopting Release that it would not apply an ownership test to determine whether a collective investment vehicle qualified as a U.S. person and declines to categorically exclude investment vehicles offered publicly only to non-U.S. persons from the U.S. person definition.

4. Foreign Branches of U.S. Entities

Consistent with the Proposed Rules, the U.S. person definition in the Final Rules focuses on the status of the particular legal person, and includes all U.S. and non-U.S. branches, agencies and offices of that person. As discussed in Section III.A.1.b.iv and Section IV.A.1.b.iii below, however, certain activities of a foreign branch of a U.S. bank (a "Foreign Branch"), and certain activities of market participants conducted through a Foreign Branch, may be treated like activities of non-U.S. persons for determining registration thresholds, provided they are not arranged, negotiated or executed by U.S. personnel of the Foreign Branch.

To qualify as a Foreign Branch for purposes of the Final 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.

5. Certain International Organizations

The Final Rules, consistent with the Proposed Rules, expressly exclude certain international organizations from the U.S. person definition. The Final Rules exclude 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 international organizations," as well as their respective agencies and pension plans, from the definition of U.S. person. The SEC expressly rejected requests of commentators to extend the exclusion to controlled affiliates of these organizations. As a result, these affiliates will need to separately consider their status as U.S. persons.

Notably, however, as discussed further below, the exclusion of these international organizations from the U.S. person definition does not imply an exemption from the SBSD of MSBSP registration requirements

generally. Thus, international organizations that conduct dealing activity in excess of the SBSD *de minimis* threshold or that exceed MSBSP threshold levels may be required to register with the SEC, absent an exemption from the SEC. Moreover, as discussed below under Sections III.A.1.a below, a U.S. person engaged in dealing transactions with these entities will need to include those dealing transactions in determining whether the U.S. person must register as an SBSD. This could deter U.S. persons form engaging in SBS transactions with these international organizations.

6. Accounts of U.S. Persons

The Adopting Release confirms the SEC's view that the U.S. person status of any account turns on whether the direct beneficial owner of the account is itself a U.S. person. 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 any nominee for the account or the entity at which it is held or maintained, are not relevant. Conversely, accounts of non-U.S. persons do not become U.S. persons solely because they are held by a U.S. financial institution or other entity that is a U.S. person.

Where an account is owned by both U.S. persons and non-U.S. persons, the question of whether the account is a U.S. person generally should turn on whether any U.S. person-owner of the account incurs obligations under an SBS transaction.

7. Estates

Under the Final Rules, the estate of a natural person who was a resident of the United States at the time of death is itself a U.S. person. The Proposed Rules had not addressed estates because the SEC did not believe that estates were significant participants in the SBS market. While the SEC reaffirms this belief in the Adopting Release, the SEC notes that just as the SBS activity of a natural person resident in the U.S. implicates the types of risks Title VII was meant to address, so also, the estate of a U.S. resident natural person "is likely to operate within the same relationships that warranted subjecting such transactions to Title VII during the life of the decedent."[4]

8. Representations Regarding U.S. Person Status

The Final Rules permit a person to rely on a representation from its counterparty that the counterparty is not a U.S. person, unless the person knows or has reason to know that the representation is not accurate. According to the SEC, a person would have reason to know the representation is not accurate if a reasonable person should know, under all of the facts of which the person is aware, that it is not accurate.

While the SEC believes that permitting market participants to rely on these representations will "mitigate challenges" that arise from determining a counterparty's U.S. person status, the reason to know standard may create issues in large organizations with multiple points of contact with a counterparty. Because of

[4] Adopting Release, 79 FR 39102.

the reason to know exception, merely incorporating a non-U.S. person representation into a trading agreement may not be sufficient to establish that a counterparty is a non-U.S. person.

9. Differences with the CFTC's Approach

The SEC's definition of "U.S. person" under the Final Rules differs in certain respects from the CFTC's definition of the same term in its cross-border swap rules, as discussed further in Annex A hereto.

III. 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 specified "*de minimis* amount". The *de minimis* amount is $3 billion, in the case of credit default swaps, or $150 million in the case of other SBS transactions; however, in order to facilitate the orderly implementation of Title VII, the *de minimis* threshold will be $8 billion for credit default swaps and $400 million for other SBS transactions during a phase-in period ending between three and five years after an SBS data repository first receives SBS data. During this phase-in period, SEC staff will study the SBS market within the new regulatory framework, and report on the operation of the SBSD and MSBSP definitions.[5]

The Final 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 Final Rules largely confirm the approach set forth in the Proposed Rules, with a few significant exceptions discussed further below.

1. *De Minimis* Calculations for SBSDs

a. U.S. Persons

Consistent with the Proposed Rules, the Final Rules require that, in determining whether its dealing activities exceed the applicable *de minimis* amount, 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.

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[5] For more information regarding the classification of entities as SBSDs, *see* our Memorandum to Clients, dated June 8, 2012, entitled "CFTC and SEC Issue Final Rules and Guidance to Further Define the Terms 'Swap Dealer,' 'Security-Based Swap Dealer,' 'Major Swap Participant,' 'Major Security-Based Swap Participant' and 'Eligible Contract Participant.'"

b. Non-U.S. Persons

i. Generally

The Final Rules require a non-U.S. person, other than a conduit affiliate (as discussed in Section V.C below), to count against its *de minimis* amount, any SBS dealing transaction with a counterparty that is either

> (i) a U.S. person (other than a transaction conducted through a Foreign Branch, to the extent described in Section III.A.1.b.iv below, or a transaction with a majority-owned affiliate); or
>
> (ii) a non-U.S. person, but only if that non-U.S. person counterparty has a right of recourse against a U.S. person that is controlling, controlled by or under common control with such non-U.S. person.

ii. Right of Recourse (Guarantors)

In an important change from the Proposed Rules, the Final Rules require that a non-U.S. person transacting in a dealing capacity with a non-U.S. counterparty must include that transaction in its *de minimis* calculation if the counterparty has a "right of recourse" against a U.S. person that is controlling, controlled by or under common control with such other non-U.S. person (e.g., if the dealer is guaranteed by a U.S. affiliate).[6] A "right of recourse" against a U.S. person exists if the counterparty has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments, or otherwise collect from, the U.S. person in connection with the non-U.S. person's obligations under the SBS transaction. This definition has several important distinctions from a traditional unconditional guarantee:

- The right of recourse may be conditional (e.g., the right of recourse may be conditional on the counterparty bringing suit against the primary obligor first or upon the primary obligor's insolvency);
- The right of recourse does not have to be in full but may only be for a portion of the obligation; and
- The right of recourse may be several and does not have to be joint and several.

The SEC in the Adopting Release stresses that a right of recourse may arise in a number of ways and does not need to be reduced to writing (so long as it is legally enforceable). The SEC gives as examples a U.S. person who is a shareholder of a foreign unlimited liability company or who is a partner of a general partnership. The right of recourse, however, must exist at the outset of the transaction. Thus, according to the SEC, a right of recourse would not arise where the rights arise after the transaction is entered into by operation of law, such as due to later actions that evidence a disregard of corporate form. Also, an agreement that does not provide a direct right of enforcement to the counterparty, such as an intercompany keep well or support agreement, would not appear to meet the right of recourse standard.

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[6] For these purposes, control is defined as the power to direct or cause the direction of the management and policies of a person.

In the Adopting Release, the SEC reasoned that the changes from the Proposed Rules were necessary because a U.S. person (e.g., the guarantor of the non-U.S. dealer) was exposed to risk as a result of the non-U.S. dealer's dealing activities, and that the economic reality of a right of recourse is that the U.S. person (the "guarantor") is effectively engaged in the dealing activity of its non-U.S. affiliate by providing the necessary credit support for the non-U.S. person to engage in the dealing activity.

The SEC, however, did not go as far as some commentators and at least one SEC Commissioner who advanced the view that all dealing transactions by any foreign subsidiary of a U.S. person should be counted toward the *de minimis* threshold. This view was based on a so-called "implicit" guarantee that the U.S. parent would not let a foreign subsidiary fail.

The Final Rules differ from the CFTC's treatment of guarantees, as further discussed in Annex A hereto.

iii. Unsolicited Transactions

Under Rule 15a-6 of the Exchange Act, which provides exemptions from registration under the Exchange Act for foreign broker-dealers engaging in transactions with U.S. persons, a foreign broker-dealer may engage in securities transactions with a U.S. person without triggering broker-dealer registration if the securities transaction is not solicited by the foreign broker-dealer. The basis for this exemption has been that broker-dealer registration should not be required where the U.S. investor seeks out the non-U.S. broker-dealer to effect a securities transaction outside the United States. The SEC in the Adopting Release refuses to extend this reasoning to foreign SBS dealers. Thus, a foreign entity engaged in SBS dealing activities must include each SBS transaction with a U.S. person in calculating the *de minimis* threshold even if the SBS transaction is unsolicited and effected outside the United States.

iv. Exception for Transactions by non-U.S. Persons with Foreign Branches

In the Proposing Release, the SEC recognized 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 conducted their SBS dealing activity through Foreign Branches. Accordingly, the Proposed Rules would have allowed 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* calculation, provided that the SBS transaction was not solicited, negotiated or executed by a person within the United States on behalf of either counterparty.

The Final Rules significantly reduce the scope of this exclusion from the Proposed Rules. The Final Rules require that:

> (i) the U.S. bank that is acting through its Foreign Branch must be a registered SBSD (except that this requirement does not apply with respect to any transaction entered into prior to 60 days following the earliest date on which SBSD registration is required, since a non-U.S. person at that

time would not be able to know with certainty whether the counterparty would register as an SBSD); and

(ii) the transaction must be "conducted through a Foreign Branch".

Under the Final Rules, a transaction is only "conducted through a Foreign Branch" if

- the Foreign Branch is the counterparty to the SBS transaction; and
- the SBS transaction is arranged, negotiated and executed on behalf of the Foreign Branch solely by persons located outside the U.S. The Final Rules would permit a non-U.S. person to rely on a representation from its counterparty that the transaction was arranged, negotiated or executed on behalf of the Foreign Branch solely by persons located outside the United States, unless the non-U.S. person knew or had reason to know that the representation was not accurate. In the Adopting Release, the SEC indicates that a person has reason to know the representation is not accurate if a reasonable person should know, under all of the facts of which the person is aware, that it is not accurate.

Notably, the Final Rules address SBS transactions that are "**arranged**, negotiated and executed" solely by persons located outside the United States. The Proposed Rules, by contrast, addressed transactions that were "**solicited**, negotiated and executed" by persons outside the United States. The use of the word "arranged" instead of "solicited" is consistent with the SEC's rejection of an unsolicited exemption to SBSD registration as discussed above and reflects the SEC's view that a person may engage in dealing activity not only through transactions that the person actively solicits but also through transactions that result from counterparties reaching out to the person.

v. Non-U.S. Person Counterparty Guaranteed by a U.S. Person

As noted above, consistent with the Proposed Rules, a non-U.S. person (other than a conduit affiliate) does not need to count against its *de minimis* threshold any dealing transactions with a non-U.S. counterparty, even if that non-U.S. counterparty is guaranteed or otherwise supported by U.S. persons.

c. Exception for Transactions Among Majority-Owned Affiliates

The Adopting Release confirms that all cross-border SBS transactions among "majority-owned affiliates" need not be considered in determining whether a person is an SBSD. The Proposing Release stated that 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 exception was first set out in the SEC and CFTC's joint release in May 2012 entitled "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"),[7] and applies to U.S. persons as well as non-U.S. persons. This exception, however, does not apply to "conduit affiliates".

d. Foreign Public Sector Financial Institutions

In the Proposing Release, the SEC noted that several commenters had requested that foreign public sector financial institutions ("FPSFIs") be excluded from the SBSD and MSBSP definitions 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. Citing a lack of "information regarding the types, levels, and natures" of SBS activity in which FPSFIs regularly engage, the Proposing Release had invited comment on the basis, if any, on which FPSFIs might be excluded from the application of the SBSD and MSBSP definitions generally applicable to non-U.S. persons.[8]

In the Adopting Release, in response to the comment that FPSFIs should not be subject to the possibility of SBSD regulation for comity reasons, the SEC noted that such issues are best addressed on a case-by-case basis, but that the prospect of SBSD regulation is relevant only to the extent that a person engages in SBS dealing activity in excess of the *de minimis* threshold. Accordingly, it appears that FPSFIs that cross the SBSD or MSBSP thresholds may be subject to registration as SBSDs or MSBSPs, as applicable, absent an exemption from the SEC.

B. AGGREGATION RULES FOR *DE MINIMIS* CALCULATIONS

In 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 Final Rules are largely consistent with the approach taken in the Intermediary Definitions Adopting Release and the Proposing Release, although they modify the aggregation principles set forth in the Proposed Rules in some significant respects.

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 Final Rules that person's transactions would be aggregated with:

- all transactions entered into in connection with the dealing activities of its U.S. affiliates (including transactions conducted through a Foreign Branch);
- all transactions entered into in connection with the dealing activities of its conduit affiliates; and
- all transactions entered into in connection with the dealing activities of its non-U.S. affiliates (to the extent any such non-U.S. affiliate counted such transaction toward its own *de minimis* calculation).

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[7] *See* "Further Definition of 'Swap Dealer,' 'Security-Based Swap Dealer,' 'Major Swap Participant,' 'Major Security-Based Swap Participant' and 'Eligible Contract Participant,' (Apr. 27, 2012), 77 FR 30596 (May 23, 2012).

[8] Proposing Release, 78 FR 31034.

The SEC indicates in the Adopting Release that aggregation is necessary to prevent the avoidance of SBSD registration by an entity dividing up its dealing activity among affiliates in order to keep each affiliate below the *de minimis* threshold. The SEC in the Adopting Release defines "control" for these purposes as the power to direct or cause the direction of the management and polices of a person.

If the aggregate SBS dealing activity of an affiliated group, as so calculated, exceeds the *de minimis* amount, then one or more of the members of the group that had transactions included in the *de minimis* calculation would need to register with the SEC as an SBSD until the dealing activity of the affiliated group conducted by unregistered SBSDs fell below the *de minimis* threshold.

1. Exception for Transactions by Registered SBSD Affiliates and Affiliates in the Process of Registering

Under the Final 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; or
- is in the process of registering as an SBSD.

The Adopting Release states that its decision to permit a person to exclude from its *de minimis* calculations the transactions of its affiliates in the process of registering as SBSDs was intended to avoid market disruption that might otherwise result from a person intermittently exceeding the *de minimis* threshold when its affiliates are in the process of registering.

These exclusions under the Final Rules modify the Proposed Rules, which would have permitted a person to exclude from its *de minimis* calculations the SBS dealing transactions of any affiliate registered as an SBSD, only if the person's SBS activities were "operationally independent" from those of its registered SBSD affiliate.[9] According to the Adopting Release, the SEC decided to drop the "operationally independent" condition in order to "facilitate efficiency and avoid deterring beneficial group-wide risk management practices."[10]

C. EXCEPTION FOR CLEARED ANONYMOUS TRANSACTIONS

The Final Rules would permit a non-U.S. person (other than a conduit affiliate) to exclude from its *de minimis* calculations SBS transactions that the non-U.S. person enters into anonymously on an execution facility or national securities exchange and that are cleared through a clearing agency. Further, the Final Rules permit any U.S. or non-U.S. affiliate of such non-U.S. person not to count such transactions of the non-U.S. person against the affiliate's own threshold for purposes of the aggregation provisions (unless the non-U.S. person is a conduit affiliate).

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[9] Proposing Release, 78 FR 31005.

[10] Adopting Release, 79 FR 39114.

An SBS transaction is considered to be anonymous for the purposes of this exception if the counterparty to the transaction is unknown to the non-U.S. person prior to the transaction. For example, the Adopting Release clarifies that an SBS transaction would not be anonymous if a person submitted the transaction to an SBS execution facility after accepting a request for a quotation from a known counterparty or a known group of potential counterparties, even if the process of submitting the transaction did not itself involve a named counterparty.

The Adopting Release states that the exclusion for anonymous transactions would not be available to conduit affiliates because conduit affiliates must count all of their SBS dealing transactions against their *de minimis* thresholds irrespective of whether their counterparty is a U.S. or a non-U.S. person. Therefore, the anonymous nature of the transaction would not pose the kind of implementation issues for conduit affiliates that it would for non-conduit affiliates.

D. RUN-OFF ENTITIES AND PORTFOLIO COMPRESSION

The SEC in the Adopting Release rejected commentators' requests for exemptions for run-off entities and portfolio compression transactions. The SEC noted that it had refused to adopt such categorical exemptions in the Intermediary Definitions Adopting Release and that only dealing activities must be counted for purposes of the *de minimis* threshold.

IV. APPLICATION OF THE TERRITORIAL APPROACH TO MSBSPS

A. REGISTRATION OF MSBSPS AND APPLICABLE REQUIREMENTS

While the statutory focus for SBSDs is primarily on activities that raise concerns that require dealer regulation, the focus for registration of MSBSPs is on positions that may pose systemic risk concerns within the U.S. In the Intermediary Definitions Adopting Release, the SEC sought to provide guidance for identifying market participants whose SBS positions posed market risks that would require monitoring and regulation. The Proposed Rules contained a framework by which U.S. persons and non-U.S. persons could determine whether they qualified as MSBSPs in the context of their cross-border SBS activities. The Final Rules largely confirm the Proposed Rules, with some significant changes relating to conduit affiliates, the treatment of SBS positions guaranteed by U.S. persons and SBS positions resulting from transactions conducted through Foreign Branches.

1. Calculation of SBS Positions

a. U.S. Persons

Under the Final Rules, consistent with the Proposed Rules, a U.S. person (including a Foreign Branch) would be required to consider all its SBS positions when determining its MSBSP status.

b. Non-U.S. Persons

The Final Rules would require non-U.S. persons (other than conduit affiliates) to include in their MSBSP threshold calculations their SBS transactions with U.S. persons, subject to exceptions for certain transactions conducted through Foreign Branches and transactions among majority-owned affiliates. The Proposed Rules would have required a non-U.S. person to include its SBS positions with Foreign Branches in determining its MSBSP status. Under the Proposed Rules, SBS transactions between non-U.S. counterparties would have been disregarded for the purpose of calculating the MSBSP threshold, even if such SBS transactions were guaranteed by U.S. persons. The Final Rules modify or reverse these Proposed Rules, as discussed further below.

i. Transactions with U.S. Clearing Agencies Included

The SEC in the Adopting Release expressly rejected a request of a commentator to exclude transactions by non-U.S. persons with U.S. clearing agencies from the determination of MSBSP status. The SEC rejected the request on the basis that transactions with U.S. clearing agencies create the type of risk in the United States that the MSBSP definition is designed to address and that the definition of substantial position applies only a 0.1 times potential future exposure to SBS transactions with registered or exempt clearing agencies.

ii. Treatment of Guaranteed Positions

The Proposed Rules would not have required a non-U.S. person to count towards its MSBSP calculation thresholds any SBS positions entered into with a non-U.S. counterparty, even if the non-U.S. counterparty had the benefit of a guarantee from a U.S. person. By contrast, the Final Rules require a non-U.S. person to include in its MSBSP threshold calculations positions for which the non-U.S. person's counterparty has rights of recourse against a U.S. person.

For this purpose, the phrase "rights of recourse" has the same meaning as it does in the SBSD context, except that, unlike the corresponding rule for SBSDs, the right of recourse does not have to be against an affiliate to be included in the MSBSP threshold calculations; accordingly, the Final Rules for MSBSP threshold calculations require the inclusion of all SBS positions guaranteed by U.S. persons, whether affiliated or unaffiliated. Conversely, however, a non-U.S. person is not required to include in its MSBSP threshold calculations any position for which it (as opposed to its counterparty) is the beneficiary of a right of recourse against a U.S. person.

iii. Transactions With Foreign Branches

The Final Rules permit a non-U.S. person (other than a conduit affiliate) to exclude from its MSBSP calculations any SBS transactions conducted through a Foreign Branch of the counterparty, if such counterparty is registered as an SBSD. The Final Rules also permit a non-U.S. person to exclude from its MSBSP calculations any SBS transaction conducted through a Foreign Branch prior to 60 days following the earliest date on which the registration of SBSDs is first required; the Adopting Release indicates that,

prior to that time, a non-U.S. person would not be able to know with certainty whether the U.S. person would, in the future, register as an SBSD.

c. Exception for Transactions Among Majority-Owned Affiliates

The Adopting Release confirms that, in determining its MSBSP status, neither a U.S. person nor a non-U.S. person will be required to include SBS transactions with counterparties that are majority-owned affiliates. This exception, however, is subject to the treatment of conduit affiliates.

2. Attribution Rules for Guaranteed Transactions

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

For purposes of the MSBSP determination under the Final Rules, a U.S. person that guarantees (or otherwise supports through a right of recourse against it) an SBS transaction would, subject to the exceptions discussed in paragraph c. below, attribute to itself all such supported SBS positions for which it provides a guarantee (or a right of recourse), irrespective of whether the beneficiary of the guarantee (or right of recourse) is a U.S. person or a non-U.S. person. As under the Proposed Rules, this attribution rule is intended to reflect the risk that the U.S. person providing the guarantee (or right of recourse) might pose to the U.S. financial system.

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

For the purpose of the MSBSP determination under the Final Rules, a non-U.S. person would, subject to the exceptions discussed in paragraph c. below, attribute to itself the SBS positions that it guarantees (or otherwise supports through a right of recourse against it) of:

- all U.S. persons; and
- all non-U.S. persons with U.S. person counterparties, other than a transaction conducted with a Foreign Branch, when the counterparty is a registered SBSD or the transaction is conducted prior to 60 days following the earliest date on which registration of SBSDs is required.

c. Exceptions to Attribution Requirement

In the Proposing Release, the SEC proposed 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 or is subject to capital standards adopted by its home country supervisors that are consistent in all respects with the Capital Accord of the Basel Committee on Banking ("Basel Accord"). The Final Rules adopt this approach. As a result, for purposes of MSBSP calculations, a person (whether U.S. or non-U.S.) would not aggregate transactions with:

- an entity subject to capital regulation by the SEC or CFTC, including as an SBSD, MSBSP, swap dealer, major swap participant, futures commission merchant, broker or dealer;
- an entity regulated as a bank in the United States; or

- a non-U.S. entity that is subject to capital standards adopted by its home-country supervisor that are consistent in all respects with the Basel Accord.

Further, the Adopting Release also clarifies that a non-U.S. person will not be required to attribute a person's positions for which it provides a guarantee while that person's registration as an MSBSP is pending.

3. Legacy Portfolios

In the Adopting Release, the SEC discussed certain comments regarding the possible exclusion from the MSBSP definition of entities that maintain large legacy portfolios of SBS transactions. In the Intermediary Definitions Adopting Release, the SEC and the CFTC had jointly determined that such entities should not be excluded from regulation as an MSBSP or a major swap participant, as applicable, but had explained that particular attention would be paid to special issues raised by the application of substantive rules to those legacy portfolios. The Adopting Release confirms that entities with legacy portfolios are not excluded from the MSBSP definition.

4. Transactions with FPSFIs

In the Adopting Release, the SEC noted that certain commenters had submitted that non-U.S. persons should not have to count their SBS positions with certain FPSFIs on the basis that counting such positions would constitute the impermissible regulation of those FPSFIs. The SEC disagreed with these commentators, stating that requiring a person to count those SBS positions simply reflected the application of the federal securities law to that person and its positions and did not amount to the impermissible regulation of those FPSFIs.

V. CONDUIT AFFILIATES

A. BACKGROUND

The Proposing Release considered, but did not include specific requirements for, "conduit affiliates" or other non-U.S. persons that enter into SBS transactions on behalf of their U.S. affiliates. Under the Proposed Rules, such entities would have been treated the same as any other non-U.S. person, including for the purposes of calculating their SBSD or MSBSP thresholds. However, the Proposing Release did note that the CFTC had made special provision for the treatment of non-U.S. persons that acted as "conduits" for their U.S. affiliates. The Proposing Release also sought comments on whether the SEC should, consistent with the CFTC, require a person that operates a "central booking system"—under which SBS transactions are booked to a single legal person—to be subject to applicable SBSD requirements as if the person had entered into the SBS transactions directly.

The Final Rules define the term "conduit affiliate" and prescribe specific calculation rules for conduit affiliates for the purposes of the SBSD and MSBSP threshold calculations.

B. DEFINITION

The Final Rules define a "conduit affiliate" as a non-U.S. person that is directly or indirectly majority-owned by one or more U.S. persons and that, in the regular course of business, enters into SBS transactions with one or more other non-U.S. persons or with Foreign Branches of U.S. persons that are registered SBSDs, for the purpose of hedging or mitigating risks faced by, or otherwise taking positions on behalf of, one or more U.S. affiliates (other than U.S. affiliates registered as SBSDs or MSBPs) and enters into offsetting SBS transactions or other arrangements with such U.S. affiliates to transfer the risks and benefits of those SBS transactions. The Adopting Release explains that the definition does not require the conduit affiliate to transact exclusively with non-U.S. persons and Foreign Branches registered as SBSDs; transactions with other persons would not cause the entity to fall outside the definition. Further, the Adopting Release makes clear that the hedging transactions with the U.S. affiliate do not need to be on a one-for-one basis (for example due to the netting) and do not need to transfer all of the risks and benefits to the U.S. affiliate.

The above-referenced majority-ownership standard requires that the relevant U.S. persons have:

- the right to vote or direct the vote of a majority of a class of voting shares 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.

C. TREATMENT OF CONDUIT AFFILIATES

1. Calculation of SBSD and MSBSP Thresholds by Conduit Affiliates

Under the Final Rules, conduit affiliates, unlike other non-U.S. persons, would be required to count all of their SBS dealing transactions for purposes of the SBSD threshold, and all of their SBS transactions for purposes of the MSBSP threshold (in each case, irrespective of whether the counterparty to such transaction is a U.S. person or a non-U.S. person). In the Adopting Release, the SEC reasoned that, absent a requirement that conduit affiliates count all their relevant SBS transactions towards the SBSD and MSBSP thresholds, a U.S. person might engage in unregistered dealing activity by having a non-U.S. affiliate enter into dealing transactions with other non-U.S. persons or with Foreign Branches of U.S. persons that are registered SBSDs. The U.S. person could then enter into offsetting transactions with the conduit affiliate, and those offsetting transactions would not be counted against the SBSD or MSBSP threshold, as applicable, due to the majority-owned exception to the SBSD or MSBSP threshold calculation rules.

However, the Adopting Release clarifies that the conduit affiliate definition does not include entities that may otherwise engage in relevant activity on behalf of U.S. affiliates registered as SBSDs or MSBSPs, since the majority of transactions involving SBSDs or MSBSPs and their foreign affiliates do not raise the types of concerns sought to be addressed by the conduit affiliate concept.

2. Anti-evasion Purpose

The Adopting Release clarifies that the SEC sees the conduit affiliate concept as a prophylactic anti-evasion measure. The SEC does not believe that any entities currently serve as conduit affiliates in the SBS market, particularly given that market participants had no incentive to engage in evasive measures before the comprehensive regulation of the SBS market pursuant to Title VII. The SEC also noted in the Adopting Release that it believes that centralized hedging facilities are unlikely to be affected by the Final Rules relating to conduit affiliates since a conduit affiliate must include only dealing transactions in the SBSD calculation and the SEC would not expect centralized hedge facilities to hold positions in excess of the MSBSP levels.

VI. SUBSTITUTED COMPLIANCE

A. BACKGROUND

The Proposed Rules provided that if the Title VII regime applies to a particular SBS transaction, the parties to the SBS transaction 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 to 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.

B. THE PROCESS FOR SUBSTITUTED COMPLIANCE DETERMINATIONS

The Proposed Rules sought to 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. Thus, for example, the Proposed Rules would have required that an application for a substituted compliance determination be in writing and contain, among other things, information regarding applicable requirements established by the foreign regulatory authority and the methods used by the foreign regulatory authority to 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. The Proposed Rules also stated that the SEC could choose to publish substituted compliance applications in the Federal Register and that applicants might seek confidential treatment to the extent provided under 17 CFR 200.81, which permits confidential treatment to be accorded to a request for a specified time period not exceeding 120 days.

C. MODIFICATIONS UNDER THE FINAL RULES

The Final Rules confirm the process for substituted compliance determinations set forth in the Proposed Rules, subject to four modifications. First, the Final Rules permit a substituted compliance application either by a party that would potentially comply with Exchange Act requirements through substituted compliance or by the relevant foreign financial regulatory authority or authorities—the Proposed Rules would have permitted only the former. Second, while the Proposed Rules would have sought supporting documentation on the methods used by the foreign regulatory authority to monitor compliance with applicable requirements, the Final Rules require supporting documents on the methods used by such regulators both for monitoring and for enforcement. Third, the Final Rules permit requests for confidential treatment to be submitted pursuant to any applicable provisions governing confidentiality under the Exchange Act. The SEC anticipates that confidential treatment requests will seek protection for privileged information obtained from foreign regulators. Finally, the Final Rules require the SEC to provide public notice of the request and to solicit public comments on the request (no action could be taken on the request for at least 25 days following publication).

VII. ANTIFRAUD AUTHORITY

Prior to 2010, the U.S. Courts of Appeal had held that U.S. courts had jurisdiction under the anti-fraud provisions of the federal securities laws over cross-border violations that either involved significant conduct in the United States that caused injury to non-U.S. investors or had substantial foreseeable effects on investors in the United States.

In the spring of 2010, in anticipation of the U.S. Supreme Court's then-pending decision in *Morrison v. National Australia Bank*, which considered a challenge to those earlier Courts of Appeal rulings, Congress drafted Section 929P of Dodd-Frank. In particular, Section 929P amended the Securities Act of 1933, the Exchange Act, and the Investment Advisers Act of 1940 to extend explicitly the "jurisdiction" of U.S. courts over securities fraud actions brought by the SEC and the United States Department of Justice (but not private actors) if the alleged fraud involved:

- conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or
- conduct occurring outside the United States that has a foreseeable substantial effect within the United States.

On June 24, 2010, the Supreme Court issued its opinion in *Morrison*,[11] holding that, although U.S. courts had (and always have had) "jurisdiction" over fraud actions based on foreign conduct, the scope of Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, did not cover securities fraud claims

[11] 561 U.S. 247, 273 (2010).

unless the purchase or sale occurred in the United States.[12] No change was made in the draft language of Section 929P to address the Supreme Court's opinion.

Although the SEC indicates its view in the Adopting Release that Section 929P was intended to overrule *Morrison* to the extent it limited cross-border actions by the SEC, a U.S. district court questioned whether Section 929P merely extended the ***jurisdiction*** of district courts to cross-border actions, and thus had no impact on *Morrison's* holding concerning the scope of the antifraud provisions of the federal securities laws.[13] The district court, however, did not decide the issue. In the Adopting Release and Final Rules, the SEC seeks to clearly set forth and codify its interpretation of the scope of its cross-border securities fraud authority under Section 929P.

The SEC in the Adopting Release states its view that Section 929P codifies the prior decisions of U.S. Courts of Appeal on the cross-border reach of the anti-fraud provisions of the federal securities laws. Accordingly, the Final Rules provide that, notwithstanding any other SEC rule or regulation, the antifraud provisions of the securities laws apply to actions brought by the SEC or the United States concerning:

- conduct within the United States that constitutes significant steps in furtherance of the violation; and
- conduct occurring outside the United States that has a foreseeable substantial effect within the United States.

The Final Rules provide that those provisions apply even if the violation:

- relates to a securities transaction occurring outside the United States that involves only foreign investors; or
- is committed by a foreign adviser and involves only foreign investors.

Further, the SEC notes that *Morrison* does not preclude the SEC's interpretation of Section 929P and that the Final Rule is, at a minimum, a reasonable interpretation of Section 929P. The Final Rules, as well as these views of the SEC, may well be subject to future litigation.

VIII. CONCLUSION

The Final Rules will become effective on September 8, 2014. The Final Rules address only some of the many issues covered by the Proposing Release. The SEC has therefore indicated that the Final Rules

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[12] For more information regarding the decision in *Morrison* and lower courts' interpretation of it, *see* our Memorandum to Clients, dated June 25, 2010, entitled "Securities Class Action Claims Based on Purchases or Sales of Securities Outside the United States," our Memorandum to Clients, dated January 3, 2011, entitled "Extraterritorial Application of Section 10(b) to Security-Based Swap Agreements," our Memorandum to Clients, dated September 29, 2011, entitled "The Territorial Reach of U.S. Securities Law After *Morrison* v. *National Australia Bank*," and our Memorandum to Clients, dated September 11, 2013, entitled "Extraterritorial Application of Criminal Securities Fraud Liability."

[13] *SEC* v. *A Chicago Convention Center, LLC*, 961 F. Supp. 2d 905 (N.D. Ill. 2013).

are the first of several rules on cross-border SBS transactions. However, it is clear that subsequent rules on cross-border SBS transactions will make use of a number of concepts in the Final Rules, such as the distinction between U.S. persons and non-U.S. persons and the treatment of Foreign Branches.

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Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 800 lawyers on four continents, with four offices in the United States, including its headquarters in New York, three offices in Europe, two in Australia and three in Asia.

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ANNEX A

SELECTED DIFFERENCES BETWEEN CFTC GUIDANCE AND SEC ADOPTING RELEASE

#	SUBJECT	CFTC GUIDANCE	SEC ADOPTING RELEASE
1.	**DEFINITION OF "U.S. PERSON."**		
	LEGAL ENTITIES	The CFTC Guidance specifically enumerates as U.S. persons "any corporation, partnership, limited liability company, business or other trust, association, joint stock company, fund or other form of enterprise similar to any of the foregoing" that is organized or incorporated under the laws of United States or that has its principal place of business in the United States. **Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45292, July 26, 2013 ("CFTC Guidance") at 45317.** U.S. person also includes any legal entity (other than other than a limited liability company, limited liability partnership or similar entity where all of the owners of the entity have limited liability), wherever organized, that is directly or indirectly majority-owned by U.S. persons and in which such U.S. persons bear unlimited responsibility for the liabilities of the entity. **CFTC Guidance at 45312, 45317.**	Under the SEC's Final Rules, any partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated or established under the laws of, or having its principal place of business in, the United States is a U.S. person. **17 CFR § 240.3a71-3(a)(4)(i)(B).** Mere U.S. person status of a commodity pool operator or asset manager would not necessarily cause an investment vehicle to be a U.S. person. **79 FR 39101 n.278-79.** Direct or indirect majority ownership of a legal entity by U.S. persons is not sufficient to make the entity a U.S. person where that entity is not organized, incorporated or established in the United States and does not have its principal place of business in the United States.
	COLLECTIVE INVESTMENT VEHICLES	U.S. person definition includes commodity pool, pooled account or collective investment vehicle (whether or not organized or incorporated in the United States) of which a majority ownership is held,	Direct or indirect majority ownership of a legal entity by U.S. persons is not sufficient to make the entity a U.S. person where that entity is not organized, incorporated or established in the United States and does not have its

#	SUBJECT	CFTC GUIDANCE	SEC ADOPTING RELEASE
		directly or indirectly, by a U.S. person or the operator of which would be required to register as a commodity pool operator under the CEA. **CFTC Guidance at 45317.** However, any commodity pool, pooled account, investment fund or other collective investment vehicle that is not organized or having its principal place of business in the U.S., and is publicly offered only to non-U.S. persons and not offered to U.S. persons is not considered a U.S. person. **CFTC Guidance at 45314.**	principal place of business in the United States. The Final Rules do not expressly include commodity pools and pooled accounts in the U.S. person definition although the definition includes investment vehicles. **17 CFR § 240.3a71-3(a)(4)(i)(B).** Whether a collective investment vehicle is publicly offered only to non-U.S. persons and not offered to U.S. persons does not affect the determination of whether it is a U.S. person. **Adopting Release, 79 FR 39127.**
	PENSION PLANS	U.S. person is defined to include a pension plan for the employees, officers or principals of any legal entity which is organized or incorporated under the laws of a state or which has its principal place of business within the United States, unless the pension plan is primarily for foreign employees of such legal entity. **CFTC Guidance at 45316-7.**	The Final Rules' definition of U.S. person does not separately include the pension plans for a legal entity with its principal place of business within the United States, although the legal entity itself would constitute a U.S. person. **17 CFR § 240.3a71-3(a)(4)(i)(B).**
	ACCOUNTS	An account (discretionary or not) with a single beneficial owner will be treated as a U.S. person if its beneficial owner is a U.S. person. For a joint account to be treated as a U.S. person, at least one of the beneficial owners must be a U.S. person. **CFTC Guidance at 45302, 45317.**	An account (discretionary or not) beneficially owned entirely by a U.S. person or persons will be treated as a U.S. person. For an account jointly owned by a combination of U.S. and non-U.S. persons to be treated as a U.S. person for the purposes of an SBS transaction, in general, the U.S. person status of the account should turn on whether any U.S. person-owner of the account incurs obligations under the SBS transaction. **Adopting Release, 79 FR 39102.**

#	SUBJECT	CFTC GUIDANCE	SEC ADOPTING RELEASE
	TRUSTS & ESTATES	U.S. person is defined to include any trust governed by the laws of a state or other jurisdiction within the United States, if a court within the United States is able to exercise primary supervision over the administration of the trust. **CFTC Guidance at 45317.**	The fact that a trust is governed by the law of a state or other U.S. jurisdiction, or has its principal place of business in the United States, will make it a U.S. person, irrespective of whether a court within the United States is able to exercise primary supervision over the administration of the trust. **17 CFR § 240.3a71-3(a)(4)(i)(B).**
	INTERNATIONAL ORGANIZATIONS	The CFTC Guidance does not specifically discuss whether international organizations are U.S. persons. However, the CFTC Guidance exempts non-U.S. swap dealers and major swap participants from the application of transaction-level requirements for transactions with certain international financial institutions, namely: (i) the International Monetary Fund, (ii) the World Bank, (iii) the International Development Association, (iv) International Finance Corporation, (v) Multilateral Investment Guarantee Agency, (vi) the Inter-American Development Bank, and (vii) the Inter-American Investment Corporation. **CFTC Guidance at 45353, n.531.** Moreover, the CFTC exempts certain international financial institutions such as the International Monetary Fund and the World Bank from registration as swap dealers or major swap participants. **Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant", 77 Fed. Reg.**	The following international organizations, their agencies and pension plans are not U.S. persons: (i) the International Monetary Fund, (ii) the World Bank, (iii) the Inter-American Development Bank, (iv) the Asian Development Bank, (v) the United Nations, and (vi) any other similar international organizations, their agencies and pension plans. **17 CFR § 240.3a71-3(a)(4)(iii).**

#	SUBJECT	CFTC GUIDANCE	SEC ADOPTING RELEASE
		30596, May 23, 2012 at 30693.	
2.	**REGISTRATION AS SWAP/SBS DEALERS AND THE *DE MINIMIS* THRESHOLD.**		
RECOURSE GUARANTEES		Non-U.S. persons who are guaranteed by a U.S. affiliate should generally count all of their dealing activity against the *de minimis* threshold. Under the CFTC Guidance, "guarantee" is broadly interpreted to include full and limited recourse guarantees, as well as potentially other unspecified arrangements. **CFTC Guidance at 45319-20; 45326.**	Non-U.S. guaranteed affiliates should count only those SBS dealing transactions for which the counterparty to the security-based swap has recourse against the non-U.S. person's U.S. affiliate. Recourse is defined as a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, the U.S. person in connection with the SBS transaction. **17 CFR § 240.3a71-3(b)(1)(iii)(B).**
FOREIGN BRANCHES		A swap is conducted with a foreign branch if (i) The employees negotiating and agreeing to the terms of the swap (or, if the swap is executed electronically, managing the execution of the swap), other than employees with functions that are solely clerical or ministerial, are located in such foreign branch or in another foreign branch of the U.S. bank; (ii) the foreign branch or another foreign branch is the office through which the U.S. bank makes and receives payments and deliveries under the swap on behalf of the foreign branch pursuant to a master netting or similar trading agreement, and the documentation of the swap specifies that the office for the U.S. bank is such foreign branch; (iii) the swap is entered into by such foreign branch in its normal course of business; (iv) the swap is treated as a swap of the foreign branch for tax purposes; and	Foreign Branch means any branch of a U.S. bank if: (i) The branch is located outside the United States; (ii) The branch operates for valid business reasons; (iii) The branch is engaged in the business of banking; and (iv) is subject to substantive banking regulation in the jurisdiction where located. **17 CFR § 240.3a71-3(a)(2).** An SBS transaction will be considered to be conducted through a Foreign Branch only if no persons located within the United States have been involved in arranging, negotiating or executing the transaction. **17 CFR § 240.3a71-3(a)(3)(i)(B).** A non-U.S. person that is a party to a transaction conducted through the Foreign Branch of a U.S. person need not include that transaction in its *de minimis*

#	SUBJECT	CFTC GUIDANCE	SEC ADOPTING RELEASE
		(v) the swap is reflected in the local accounts of the foreign branch. **CFTC Guidance at 45330.** However, if any material terms of the swap are arranged, negotiated or executed by employees of the U.S. bank located in the United States, the swap could be considered to be with the U.S. principal bank rather than its foreign branch. **CFTC Div. of Swap Dealer and Intermediary Oversight, CFTC Staff Advisory No. 13-69, Applicability of Transaction-Level Requirements to Activity in the United States (Nov. 14, 2013).** A non-U.S. person may exclude any swap with a foreign branch of a registered swap dealer for purposes of determining whether the non-U.S. person has exceeded the *de minimis* level of swap dealing activity under the swap dealer definition. **CFTC Guidance at 45315.**	calculation if the U.S. person is a registered SBSD (or if the transaction occurs within the 60 days following the date on which SBSD are first required to register). **17 CFR § 240.3a71-3(b)(1)(iii)(A)(1).**
	NON-U.S. COUNTERPARTY GUARANTEED BY U.S. PERSON	A non-U.S. person (that is not guaranteed by, or a conduit affiliate of, a U.S. person) should count its dealing transactions with non-U.S. counterparties that are guaranteed by U.S. persons, except where the non-U.S. counterparty is (i) a registered swap dealer, (ii) an affiliate of a registered swap dealer whose own swap dealings are below the *de minimis* level or (iii) guaranteed by a U.S. person that is not a financial entity. **CFTC Guidance at 45326.**	A non-U.S. person need not count against its *de minimis* threshold, SBS dealing transactions with a non-U.S. person whose SBS transactions are guaranteed by a U.S. person. **Adopting Release, 79 FR 39112.**

#	SUBJECT	CFTC GUIDANCE	SEC ADOPTING RELEASE
3.	**MAJOR SWAP PARTICIPANT AND MSBSP STATUS DETERMINATIONS.**		
	NON-U.S. PERSONS	In determining whether a non-U.S. person (that is not guaranteed by, or a conduit affiliate of, a U.S. person) holds swap positions above the major swap participant thresholds, the non-U.S. person should consider the aggregate notional value of any swap: (i) between it and a U.S. person, (ii) between it and a non-U.S. person that is guaranteed by a U.S. person, and (iii) between another (U.S. or non-U.S.) person and a U.S. person or non-U.S. person guaranteed by a U.S. person, where it guarantees the obligations of the other person thereunder. However, a non-U.S. person's swap positions where its own obligations thereunder are guaranteed by a U.S. person should be attributed to that U.S. person and need not be included in the non-U.S. person's determination. **CFTC Guidance at 45326.**	A non-U.S. person need not count against its MSBSP threshold SBS transactions with a non-U.S. person whose SBS transactions are guaranteed by a U.S. person. **Adopting Release, 79 FR 39135.**
	ATTRIBUTION	As noted above, a non-U.S. person must attribute to itself the aggregate notional value of any swap position which it guarantees if the swap positon is opposite a U.S. person or a person guaranteed by a U.S. person. **CFTC Guidance at 45326.**	A non-U.S. person must attribute to itself all the transactions of a U.S. person that are guaranteed by that non-U.S. person. **17 CFR § 240.3a67-10(c)(1)(ii)(A).**

#	SUBJECT	CFTC GUIDANCE	SEC ADOPTING RELEASE
4.	**CONDUIT AFFILIATES.**		
	DEFINITION	The CFTC identified four factors to use in determining whether a non-U.S. person is a "conduit affiliate": (i) the non-U.S. person is a majority-owned affiliate of a U.S. person; (ii) the non-U.S. person is controlling, controlled by or under common control with the U.S. person; (iii) the financial results of the non-U.S. person are included in the consolidated financial statements of the U.S. person; and (iv) the non-U.S. person, in the regular course of business, engages in swaps with non-U.S. third-party(ies) for the purpose of hedging or mitigating risks faced by, or to take positions on behalf of, its U.S. affiliate(s), and enters into offsetting swaps or other arrangements with its U.S. affiliate(s) in order to transfer the risks and benefits of such swaps with third party(ies) to its U.S. affiliates. **CFTC Guidance at 45359.**	The Final Rules define a "conduit affiliate" as a non-U.S. person that, in the regular course of business, enters into SBS transactions with one or more other non-U.S. persons or with Foreign Branches of U.S. persons that are registered SBSDs, for the purpose of hedging or mitigating risks faced by, or otherwise taking positions on behalf of, one or more U.S. affiliates (other than U.S. persons registered as SBSDs or MSBPs) and enters into offsetting SBS transactions or other arrangements with such U.S. affiliates to transfer the risks and benefits of those SBS transactions. A non-U.S. person that is a conduit affiliate must be directly or indirectly majority-owned by one or more U.S. persons. **17 CFR § 240.3a71-3(a)(1)(i)(A).**
5.	**SUBSTITUTED COMPLIANCE.**		
	PROCESS	While the CFTC Guidance does not specifically require supporting documentation as to monitoring and/or enforcement by the foreign financial regulator in connection with requesting a substituted compliance determination, the substituted compliance determinations that have been issued by the CFTC have relied heavily on, among other things, (i) submissions from foreign regulators, and (ii) independent CFTC review of the foreign regulatory regime in question.	The Final Rules require supporting documentation as to monitoring and/or enforcement by the foreign financial regulator. **17 CFR § 240.0-13(e).**