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THE COMMODITY FUTURES TRADING COMMISSION'S SWAPS CROSS-BORDER GUIDANCE PROPOSAL

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BACKGROUND

The Dodd-Frank Act amended the Commodity Exchange Act (the Act) to create a new regulatory framework for swaps, and added Section 2(i) to require the application of the Dodd-Frank Act swap requirements to activities that occur outside the United States only if they have a direct and significant connection with activities in, or effect on, US commerce, or to prevent evasion of the Act's swap provisions. The US Commodity Futures Trading Commission (CFTC or Commission) interprets Section 2(i) of the Act to provide relief for certain swaps and persons from the swap-related registration, entity-level, and transaction-level requirements under its proposal, depending on the extent to which a person's swap-related activities reflect a "direct and significant" connection with, or effect on, US commerce.

The Commission initially interpreted Section 2(i) of the Act in 2013 when it formally issued interpretive guidance and a policy statement on the cross-border application of certain swap rules (Cross-Border Guidance) under the Act.[1] The Commission describes the Cross-Border Guidance as "a flexible and efficient way to provide the Commission's views on cross-border issues raised by market participants, allowing the Commission to adapt in response to changes in the global regulatory and market landscape" in light of the "complex and dynamic nature of the global swap market."[2] The guidance, however, is not codified. In 2016, the Commission published proposed regulations to codify its cross-border application of swap rules under the Act, after it had adopted cross-border margin rules for uncleared swaps (Cross-Border Margin Rule).

The CFTC's latest proposal, published for comment in December 2019 (the Proposal), withdraws the 2016 cross-border proposal and proposes to codify new definitions; the CFTC's policy on a non-US swap dealer's use of agents or personnel located in the United States to arrange, negotiate, or execute swaps with Non-US Persons (Arranged, Negotiated, or Executed (ANE) transactions); and the CFTC's approaches to counting swaps toward the de minimis threshold, substituted compliance, and comparability determinations in the context of cross-border transactions.[3] In the absence of cross-border guidance, non-US swap dealers subject to CFTC registration would be required to comply with CFTC regulations (including transaction-level and entity-level requirements such as clearing, relationship documentation, risk management, external business conduct standards, and chief compliance officer, among others) that are redundant with the regulations of their home country regulatory regimes.

EXECUTIVE SUMMARY

Under the Proposal, the CFTC would overhaul its cross-border regime by introducing new definitions, a new method of counting swaps toward the swap dealer de minimis exception, and a different approach to categorizing regulatory requirements available for substituted compliance. Under the Proposal, the CFTC would do the following:

- Redefine "US Person" and "guarantee" and introduce a new type of entity referred to as a "significant risk subsidiary" (replacing the conduit affiliate category).

[1] Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45,292 (July 26, 2013).

[2] Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 Fed Reg. 952, 953 (Jan. 8, 2020) (the Proposal).

[3] The Proposal would not supersede the Commission's policy views described in the Cross-Border Guidance or elsewhere with respect to other matters that do not relate to the Commission's interpretation of Section 2(i) of the Act and the covered swap provisions set forth in the Cross-Border Guidance.

- Treat ANE transactions as any other swap between Non-US Persons.
- Codify how to count swap transactions toward the de minimis threshold, based on the status of the counterparties to the swap.
- Recategorize entity-level and transaction-level requirements and codify exceptions for certain foreign-based swaps and the CFTC's approach to substituted compliance and comparability determinations.

THE PROPOSAL'S NEW AND AMENDED DEFINITIONS

The Proposal contains new and amended definitions of important terms (including US Person; Non-US Person; United States; guarantee; Guaranteed Entity; Other Non-US Persons; Significant Risk Subsidiary (SRS); significant subsidiary; subsidiary; affiliate; control; parent entity; ultimate US parent entity; foreign branch; swap conducted through a foreign branch; swap entity; US swap entity; non-US swap entity; foreign based swap; and foreign counterparty) to assess whether a direct and significant connection exists such that certain swaps should be counted toward the swap dealer (SD) or major swap participant (MSP) de minimis threshold and subject to the cross-border application of certain Dodd-Frank Act requirements.

Definitions: US Person, Non-US Person, and United States

In an effort to identify persons whose swap-related activities have a significant nexus to the United States, the Commission has proposed that any of the following constitutes a "US Person" for purposes of swap regulation:

- A natural person resident in the United States.
- A partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the United States *or having its principal place of business in the United States*.
- An account (whether discretionary or nondiscretionary) of a US Person.
- The estate of a decedent who was a resident of the United States at the time of death.

So defined, "US Person" not only establishes a significant nexus to the United States, but also harmonizes the prospective application of the Proposal with the US Securities and Exchange Commission's (SEC's) regulations regarding cross-border securities-based swap activities (SEC Cross-Border Rule), which contains a definition consistent with the Proposal's definition. The CFTC has retained the existing "principal place of business" test in the proposed definition, but with some minor modifications described below.

The Proposal deviates from the Cross-Border Margin Rule and Cross-Border Guidance most notably with regard to determinations of principal place of business and the omission of certain legal entities that are owned by one or more US Persons and for which such persons bear unlimited responsibility for the obligations and liabilities of the legal entity (Unlimited US Responsibility).[4]

- In the Proposal, the CFTC states that activities such as formation of a fund are not highly indicative of activities, financial and legal relationships, and risks within the United States (unless the person who forms the fund directs, controls, and coordinates the investment activities of the fund on an ongoing basis). The CFTC's decision **not to include formation activities** as a consideration as to whether a fund is a US Person is a change from the current guidance.

[4] Examples of entities with Unlimited US Responsibility would include unlimited liability corporations, general partnerships, and sole proprietorships.

- In another change from current guidance, the CFTC would **no longer include a fund that is majority owned by one or more US Persons** as a US Person, recognizing that this consideration presents a significant challenge in certain circumstances, such as for fund of funds.
- The Proposal would explicitly **exclude international financial institutions**, such as the International Monetary Fund (among others), from the US Person definition.
- The CFTC **omits the current Unlimited US Responsibility prong** from the US Person definition in the Proposal, noting that this test was designed to capture persons that could give rise to risk to the US financial system in the same manner as Non-US Persons whose swap transactions are subject to explicit financial support arrangements from US Persons. The CFTC ultimately omitted the Unlimited US Responsibility prong because, in its view, the corporate structure that this test is designed to capture is not commonly in use in the marketplace.

Additionally, the Proposal also provides the definition of a "Non-US Person" as any person that is not a US Person, and defines "United States" and "US" as the United States of America, its territories and possessions, any state of the United States, and the District of Columbia.[5] The CFTC will permit a market participant to **rely on written representations** from their counterparties as to their status unless the market participant knows or should know that the representation is not accurate, and may rely on US Person representations provided under the Cross-Border Margin Rule until December 31, 2025.

Definition: Guarantee

The Proposal's definition of "guarantee" is narrower than the scope of the term in the Cross-Border Guidance but is consistent with the Cross-Border Margin Rule. Under the Proposal, the CFTC defines a "guarantee" as an arrangement, pursuant to which one party to a swap has rights of recourse against a guarantor, with respect to its counterparty's obligations under the swap. Recourse exists if the party has a conditional or unconditional legally enforceable right to receive or otherwise collect, in whole or in part, payments from the guarantor with respect to its counterparty's obligations under the swap. Further, a "guarantee" need not necessarily be included within the swap documentation, and the term would apply regardless of whether such right of recourse were conditioned upon the Non-US Person's failure to meet its obligations under the relevant swap, and regardless of whether the counterparty seeking to enforce the guarantee were required to make a demand for payment or performance from the Non-US Person before proceeding against the US guarantor.

Unlike the Cross-Border Guidance, the CFTC would not include within the scope of the definition of guarantee "other formal arrangements that, in view of all the facts and circumstances, support the non-US person's ability to pay or perform its swap obligations," including agreements such as keepwells and liquidity puts, certain indemnity agreements, matter trust agreements, and liability or loss transfer or sharing agreements. While recognizing that such arrangements and agreements transfer risk back to the US financial system, their exclusion from the definition of "guarantee" achieves a more consistent compliance framework for Non-US Persons. Specifically, by harmonizing the definition of "guarantee" with that of the Cross-Border Margin Rule, Non-US Persons can perform the same analysis for cross-border swaps under the Proposal, as they currently perform under the Cross-Border Margin Rule, without need for separate analysis.

The Proposal further provides that a Non-US Person would be considered a "Guaranteed Entity" with respect to swaps that are guaranteed by a US Person, but would not be a Guaranteed Entity with respect to swaps with other counterparties not guaranteed by a US Person. For purposes of the Proposal, swap activities involving a Guaranteed Entity would be treated similarly to swap activities otherwise involving a guarantee from a US Person, and would therefore generally satisfy the "direct and significant" test under Section 2(i) of the Act and be subject to the requirements under the Proposal. Important to note, unlike

[5] The Proposal defines other terms that provide additional clarity to the Proposal but do not reflect substantive concepts. These terms include "swap entity" (a person that is registered with the Commission as an SD or MSP pursuant to the Act); "US swap entity" (a swap entity that is a US Person); and "non-US swap entity" (a swap entity that is not a US swap entity).

the Cross-Border Guidance, a guaranteed person or entity need not be an affiliate of the guarantor to be considered a Guaranteed Entity. Finally, the Proposal includes the term "Other Non-US Person," defined as a Non-US Person that is neither a Guaranteed Entity nor a Significant Risk Subsidiary (defined below).

Definitions: Significant Risk Subsidiary and Related Terms

One of the most noteworthy changes to the Cross-Border Guidance definitions is the introduction of a new category of person, a "Significant Risk Subsidiary" (SRS), that would be treated the same as a US Person for purposes of the Proposal. A Non-US Person would be considered an SRS if

- the Non-US Person is a "significant subsidiary" of an "ultimate US parent entity," as those terms are defined in the Proposal;
- the "ultimate US parent entity" has more than $50 billion in global consolidated assets, as determined in accordance with US generally accepted accounting principles (GAAP) at the end of the most recently completed fiscal year; and
- the Non-US Person is **not subject** to either (1) consolidated supervision and regulation by the Board of Governors of the Federal Reserve System (Federal Reserve Board) as a subsidiary of a US bank holding company (BHC), or (2) capital standards and oversight by the Non-US Person's home country regulator that are consistent with the Basel Committee on Banking Supervision's International Regulatory Framework for Banks (Basel III) and margin requirements for uncleared swaps in a jurisdiction for which the Commission has issued a comparability determination (CFTC Margin Determination) with respect to uncleared swap margin requirements.

Significant Subsidiaries

While the Proposal requires a US parent entity to exceed a $50 billion consolidated asset threshold for purposes of classifying a non-US subsidiary as an SRS, the non-US subsidiary must also be a "significant subsidiary."

As noted by the Commission, the $50 billion threshold and quantitative tests are designed to ensure that only non-US subsidiaries with US parents that pose systemic risk to the US financial system are captured within the Proposal's requirements applicable to US Persons, consistent with Section 2(i) of the Act. Consistent with, but not identical to, SEC Regulation S-X and the Federal Reserve Board's financial statement filing requirements for foreign subsidiaries of US banking organizations, the Proposal defines "significant subsidiary" as a subsidiary that meets one of the following three quantitative tests:

1. *Equity Capital Significance Test*: The three-year rolling average of the subsidiary's equity capital is equal to or greater than 5% of the three-year rolling average of its ultimate US parent entity's consolidated equity capital, as determined in accordance with US GAAP at the end of the most recently completed fiscal year.
2. *Revenue Significance Test*: The three-year rolling average of the subsidiary's revenue is equal to or greater than 10% of the three-year rolling average of its ultimate US parent entity's consolidated revenue, as determined in accordance with US GAAP at the end of the most recently completed fiscal year.
3. *Asset Significance Test*: The three-year rolling average of the subsidiary's assets are equal to or greater than 10% of the three-year rolling average of its ultimate US parent entity's consolidated assets, as determined in accordance with US GAAP at the end of the most recently completed fiscal year.

Non-US Persons with US Parent Entities

Pursuant to the consolidation requirements of US GAAP, the financial statements of a US parent entity reflect the financial position of the parent entity, together with the subsidiaries in which the US parent entity has a controlling interest, including non-US subsidiaries. Such consolidation may permit US Persons to accrue risk through the swap activities of their non-US subsidiaries, which could have a significant effect on the US financial system.

According to the CFTC, consolidated non-US subsidiaries of US parent entities present a greater supervisory interest to the CFTC, relative to Other Non-US Persons. The Proposal contemplates a risk-based approach to determine which SRSs should be required to comply with the Commission's swap requirements as reflected in the definition of SRS, which includes entities whose swap obligations may not be guaranteed by US Persons but that have the potential to negatively impact the US financial system via the US parent.

Exclusions from the Definition of SRS

As noted in the definition of SRS, a Non-US Person would not be an SRS to the extent the entity is subject to prudential regulation as a subsidiary of a US BHC or is subject to comparable capital and margin standards. The Commission has taken the preliminary stance to defer regulatory oversight under the Proposal in cases where the swap activities of Non-US Persons with US BHC parents fall under the umbrella of US prudential regulation, and where the swap activities of Non-US Persons are subject to capital standards and oversight consistent with Basel III and subject to a CFTC Margin Determination. As such, to the extent that a Non-US Person is subject to either BHC or Basel III and CFTC Margin Determination oversight, such persons will not fall within the Proposal's requirements applicable to US Persons.

Other SRS Definitions

As used in the definition of SRS, the Proposal defines the following terms:

- "Subsidiary" to include a subsidiary of a specified person that is an affiliate controlled by such person directly or indirectly through one or more intermediaries
- "Affiliate" to include a person that directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with the person specified
- "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 shares, by contract, or otherwise
- "Parent entity" to mean any entity in a consolidated group that has one or more subsidiaries in which the entity has a controlling interest, in accordance with US GAAP

For purposes of designating an entity as an SRS, **a US parent entity need not be a non-US subsidiary's ultimate parent**. It is enough that a non-US subsidiary has an upstream US parent, even if such parent is an intermediate entity, and their ultimate parent is not a US Person. To address possible confusion, the Proposal provides a separate definition for a person's "ultimate US parent"; however, the risk created by even an intermediate US parent is enough to subject a non-US subsidiary to the Commission's purview. The CFTC included specific questions for comment regarding the viability of the tests to effectively capture non-US subsidiaries that may have a significant impact on the US financial system.[6]

Definitions: Foreign Branch and Swap Conducted Through a Foreign Branch

Incorporating concepts drawn from the Federal Reserve Board's Regulation K, the FDIC's International Banking Regulation, and the Office of the Comptroller of the Currency's "foreign branch" definition, the Proposal defines "foreign branch" as an office of a US Person that is a bank that

- is located outside the United States (thus identifying swap activity that is not conducted within the United States but has the potential to affect US commerce);
- operates for valid business reasons;

[6] For example, the CFTC asks: "Does the proposed SRS definition appropriately capture persons that raise greater supervisory concerns relative to Other Non-US Persons whose swap obligations are not guaranteed by a US Person? If not, how should the definition be revised? Is $50 billion an appropriate threshold to determine when an ultimate US parent entity may have a significant impact on the US financial system?"

- maintains accounts independently of the home office and of the accounts of other foreign branches, with the profit or loss accrued at each branch determined as a separate item for each foreign branch; and
- is engaged in the business of banking or finance and is subject to substantive regulation in banking or financing in the jurisdiction where it is located.

A "foreign branch" appears to be limited to foreign branches of US banks; however, the term "bank" is not defined, and the Commission is silent regarding whether a "foreign branch" would include branches of US entities that are not banks. The term "foreign branch" does not include an affiliate of a US bank that is incorporated or organized as a separate legal entity, and the Proposal does not recognize foreign branches of US Persons separately from their US principal for purposes of registration. As such, if a foreign branch's swap activity exceeds the relevant SD or MSP registration thresholds, the US Person would be required to register, and the registration would encompass the foreign branch. The overall intent of this definition, and its associated carve-outs, is to provide relief from certain requirements under the Proposal to the extent that swap activity not conducted within the United States remains subject to appropriate foreign oversight and regulation.

The Proposal defines the phrase "swap conducted through a foreign branch," which is intended to serve as an anti-evasion measure to prevent a US bank from routing swaps for booking through a foreign branch for purposes of the SD and MSP registration thresholds or to avoid certain regulatory requirements applicable to registered SDs or MSPs. The term refers to a swap entered into by a foreign branch where

- the foreign branch or another foreign branch is the office through which the US Person makes and receives payments and deliveries under the swap pursuant to a master netting or similar trading agreement, and the documentation of the swap specifies that the office for the US Person is such foreign branch;
- the swap is entered into by such foreign branch in its normal course of business; and
- the swap is reflected in the local accounts of the foreign branch.

Definitions: US Branch and Swap Conducted Through a US Branch

The Proposal includes the term "US branch," defined as a branch or agency of a non-US banking organization where such branch or agency (1) is located in the United States; (2) maintains accounts independently of the home office and other US branches, with the profit or loss accrued at each branch determined as a separate item for each US branch; and (3) engages in the business of banking and is subject to substantive banking regulation in the state or district where located. A "US branch" appears limited to branches of non-US banking organizations; however, the term "banking organization" is not defined, and the Commission is silent regarding whether a "US branch" would include branches of foreign entities that are not banking organizations.

Further, the Proposal includes the term "swap conducted through a US branch," defined as a swap entered into by a US branch where (1) the US branch is the office through which the Non-US Person makes and receives payments and deliveries under the swap pursuant to a master netting or similar trading agreement, and the documentation of the swap specifies that the office for the Non-US Person is such US branch; or (2) the swap is reflected in the local accounts of the US branch.

In contrast to the definitions of "foreign branch" and "swap conducted through a foreign branch," these terms are intended to identify swap activity that should be considered to take place in the United States and, thus, remain subject to the requirements of the Proposal. Specifically, these terms address instances in which an entity might operate outside the United States to evade Dodd-Frank Act requirements and CFTC regulations for a swap, yet still attempts to benefit from the swap taking place in the United States. As swaps conducted through a US branch have a greater potential to affect US commerce than swaps conducted through a foreign branch, a focus on the regulation of US branches fits squarely within the Commission's intended goals.

Definitions: Foreign-Based Swap and Foreign Counterparty

The Proposal defines "foreign-based swap" as (1) a swap by a non-US swap entity, except for a swap conducted through a US branch; or (2) a swap conducted through a foreign branch. Further, the Proposal includes the term "foreign counterparty," defined as (1) a Non-US Person, except with respect to a swap conducted through a US branch of that Non-US Person; or (2) a foreign branch where it enters into a swap in a manner that satisfies the definition of a swap conducted through a foreign branch.

These terms are intended to be used to determine which swaps should be considered indicative of a foreign-based swap, and which swaps should be considered indicative of a "domestic swap". Foreign-based swaps generally consist of a swap by a non-US swap entity, except for a swap conducted through a US branch, and a swap conducted through a foreign branch such that it would satisfy the definition of a foreign-based swap. Although the term "domestic swap" is not a defined term in the Proposal, the CFTC explains that domestic swaps generally consist of swaps of non-US swap entities that are conducted through a US branch of that swap entity, and swaps of foreign branches of US swap entities where the foreign branch does not enter into the swaps in a manner that satisfies the definition of a swap conducted through a foreign branch. Certain foreign-based swaps are eligible for newly proposed exceptions, described further below.

ARRANGED, NEGOTIATED, OR EXECUTED (ANE) TRANSACTIONS

Subsequent to the issuance of the Cross-Border Guidance, the Commission's Division of Swap Dealer and Intermediary Oversight (DSIO) issued an advisory that took the position that a non-US swap dealer's personnel or agents located in the United States who regularly arrange, negotiate, or execute swaps for or on behalf of the swap dealer perform "core, front-office activities of that SD's dealing business," and therefore the non-US swap dealer would be required to comply with the CFTC's transaction-level requirements.[7] Subsequently, DSIO stepped back from this position, issuing no-action relief from the advisory's requirements and a request for comment on the topic.[8] Commenters explained that risks associated with ANE transactions lie outside the United States, and that US personnel are involved for the convenience of a non-US swap dealer's global customers.

The Proposal would treat all foreign-based swaps entered into between a non-US swap dealer and a Non-US Person the same regardless of whether the swap were an ANE transaction, thus superseding the DSIO advisory with respect to the application of certain requirements (the new categories of swap dealer requirements, "Groups B and C" requirements, described below). The CFTC supports the new position in the Proposal based on policy considerations, including undue market distortions and international comity. The CFTC also points to commenters' concerns that the DSIO advisory's requirements could cause non-US SDs to relocate personnel to other countries. Moreover, the CFTC appears to agree with commenters that the financial risk of the transactions is outside the United States because the transactions involve two Non-US Persons who likely are subject to regulation and oversight in their home jurisdictions, especially considering that most of the major swap trading centers have implemented risk mitigation requirements similar to those of the CFTC. The CFTC would continue to have antifraud and anti-manipulation authority over ANE transactions.

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[7] CFTC Staff Advisory No. 13-69 (Nov. 14, 2013).

[8] CFTC No-Action Letter No. 13-71 (Nov. 26, 2013) (extended in CFTC Letter Nos. 14-01, 14-74, 14-140, 15-48, 16,64, and 17-36); Request for Comment on Application of Commission Regulations to Swaps Between Non-US Swap Dealers and Non-US Counterparties Involving Personnel or Agents of the Non-US Swap Dealers Located in the United States, 79 Fed Reg. 1,347 (Jan. 8, 2014).

SWAP DEALER REGISTRATION THRESHOLDS IN THE CROSS-BORDER CONTEXT

Swap dealers are not subject to registration as such until they meet the de minimis threshold, generally meaning that a swap dealer, over the course of the immediately preceding 12 months, may enter into swaps with an aggregate gross notional amount of up to $8 billion (or $25 million if the counterparty is a "special entity") without needing to register as a swap dealer. The Proposal addresses the application of the de minimis threshold to the cross-border swap dealing transactions of US and Non-US Persons in connection with swap dealer and major swap participant registration. Whether a swap is counted toward the swap dealer de minimis threshold depends in large part on the status of the counterparty. A person (with the exception of an SRS) need not count toward the threshold swaps that are anonymously entered into on a registered designated contract market, swap execution facility (registered or exempt from registration), or registered foreign board of trade, as long as the swap is cleared by a derivatives clearing organization (registered or exempt from registration).

Counting Swaps Toward the Swap Dealer De Minimis Threshold

Swaps by a Significant Risk Subsidiary

Under the Proposed Rule, an SRS would include all of its dealing swaps in its de minimis threshold calculation without exception. Swap dealing activities of an SRS's branches would be included in the calculation because the SRS determination is made at the entity level. The CFTC states that an SRS should be treated the same as a US Person to prevent the creation of a "substantial regulatory loophole" that would incentivize US Persons to conduct their dealing business with Non-US Persons through an SRS and to avoid the application of relevant Dodd-Frank Act requirements. The Proposal, however, does not require an Other Non-US Person to count dealing swaps with an SRS unless the SRS was a Guaranteed Entity and no exception applied. The CFTC provides this relief to Other Non-US Persons to prevent them from no longer engaging in swap activities with SRSs.

Swaps with a US Person

Consistent with the Cross-Border Guidance, the Proposal would require a Non-US Person to count all dealing swaps with a counterparty that is a US Person toward its de minimis threshold calculation, except for swaps with a counterparty that is a foreign branch of a US swap dealer (provided that the swaps are "conducted through a foreign branch" of the registered swap dealer). According to the CFTC, a non-US swap dealer's US counterparties could be negatively affected if the non-US swap dealer became insolvent or defaulted. However, such swap activity would not be completely outside the scope of the Dodd-Frank Act regime because a swap conducted through a foreign branch of a registered swap dealer would trigger certain Dodd-Frank Act transactional requirements, including margin requirements. The exception is not available for Guaranteed Entities or SRSs.

Swaps Subject to a Guarantee

The CFTC proposes to require a Non-US Person to include in its de minimis threshold calculation swap dealing transactions where its obligations under the swaps are subject to a guarantee by a US Person. Under the Proposal, a Non-US Person must count dealing swaps with a Guaranteed Entity except when (1) the Guaranteed Entity is a registered swap dealer, or (2) the Guaranteed Entity's swaps are subject to a guarantee by a US Person that is a nonfinancial entity.

Counting Swaps Toward the MSP Thresholds

The CFTC requires a person to register as an MSP if the person's swap positions exceed one of several thresholds. Consistent with prior interpretative guidance, the "attribution requirement" would apply to the MSP analysis. In practice, this means that an entity's swaps would be attributed to a parent, other affiliate, or guarantor to the extent that the counterparties to those swaps have recourse to the parent, other affiliate, or guarantor with respect to the swap position and the parent, other affiliate, or guarantor

is not subject to capital regulation by the CFTC, the SEC, or a prudential regulator (referred to as the attribution requirement).

If a person is a **US Person**, Guaranteed Entity, or Significant Risk Subsidiary, the person would be required to count all of its swap positions toward the MSP thresholds. The Proposal would require an Other Non-US Person to count all swaps with a (1) US Person, except those conducted through a foreign branch of a registered swap dealer, and (2) Guaranteed Entity, with certain exceptions, toward the MSP thresholds.

Aggregation Requirement

Consistent with the Cross-Border Guidance, the Proposal would require a person to aggregate all of its dealing swaps with those of persons controlling, controlled by, or under common control with the person as long as such other persons are required to include the relevant swaps in their de minimis calculations (unless the affiliated person is a registered swap dealer). When an affiliated group meets the de minimis threshold, at least one of the affiliates must become registered as a swap dealer, with the other affiliates' swap dealing activities remaining below the de minimis threshold.

NEW APPROACH TO SUBSTITUTED COMPLIANCE

The Proposal would eliminate the Cross-Border Guidance classifications of Entity-Level Requirements and Transaction-Level Requirements, creating new categories of requirements, classified as "Groups A, B, and C Requirements." The Proposal provides exceptions from certain of these requirements, as set forth in the table below, and allows various parties (non-US SDs, trade associations, and non-US regulatory agencies) to request the CFTC to issue a comparability determination to allow substituted compliance with swap-related requirements. Existing comparability determinations would remain effective if the Commission adopts the Proposal.

Group Requirements and Exceptions

- Group A Requirements consist of CFTC Regulations 3.3 and 23.201, 23.203, 23.600-603, 23.606-607, and 23.609 (chief compliance officer, risk management, swap data recordkeeping, and antitrust considerations). The CFTC views these requirements to be applicable on an entity-level basis as "an important line of defense against financial, operational, and compliance risks that could lead to a firm's default."
- Group B Requirements consist of CFTC Regulations 23.202 and 23.501-504 (swap trading relationship documentation, portfolio reconciliation and compression, trade confirmation, and daily trading records. The Group B Requirements may be applied based on domestic and foreign transactions or counterparty relationships rather than across an entire firm.
- Group C Requirements consist of the CFTC's external business conduct requirements (CFTC Regulations 23.400-451), described as customer protection standards.

The Proposal would provide four exceptions from certain regulations, only with respect to foreign-based swaps: (1) exchange-traded exception, (2) foreign swap Group C exception, (3) non-US swap entity Group B exception, and (4) foreign branch Group B exception. As discussed above, a foreign-based swap is a new defined term, meaning a swap by a non-US swap entity, except for a swap conducted through a US branch, or a swap conducted through a foreign branch.

EXCEPTION	APPLICABILITY	AVAILABLE RELIEF
Exchange-Traded Exception	Applies to anonymous, exchange-traded, cleared foreign-based swaps	Group B Requirements (except for daily trading records in CFTC Regulation 23.202(a)) and Group C Requirements
Foreign Swap Group C Exception	Applies to non-US swap entities and foreign branches of a US swap entity with respect to	Group C Requirements

	foreign-based swaps with a foreign counterparty (a Non-US Person, except with respect to a swap conducted through a US branch of that Non-US Person, or a foreign branch where it enters into a swap in a manner that satisfies the definition of a swap conducted through a foreign branch)	
Non-US Swap Entity Group B Exception	Applies to non-US swap entities that are Other Non-US Persons with respect to foreign-based swaps with a foreign counterparty that is also an Other Non-US Person	Group B Requirements
Foreign Branch Group B Exception	Applies to foreign branches of a US swap entity with respect to foreign-based swaps with a foreign counterparty that is an Other Non-US Person, except (1) where substituted compliance is available and (2) in any calendar quarter, the aggregate gross notional amount of swaps conducted by a swap entity in reliance on the exception may not exceed 5% of the aggregate gross notional amount of all its swaps in that calendar quarter	Group B Requirements

Substituted Compliance and Comparability Determinations

Under the Proposal, **all swap entities would remain subject to the CFTC's examination and enforcement authority**, notwithstanding any reliance on a comparability determination. As a result, the CFTC could initiate an action for a violation of its requirements if a swap entity did not comply with the foreign jurisdiction's relevant standards or the terms of the comparability determination. The Proposal is silent as to whether the foreign regulator must take action or issue a finding of noncompliance against a non-US swap entity before the CFTC would take enforcement action under these circumstances.

A non-US SD could rely on substituted compliance with respect to Group A or B Requirements if the CFTC has issued a comparability determination. In previous comparability determinations, the CFTC has found comparability with respect to certain CFTC requirements based on a combination of "robust prudential supervision coupled with supervisory guidelines to achieve comparable regulatory outcomes as the Commission requirements." For jurisdictions that implement *prudential supervisory guidelines* in the regulation of swaps, the CFTC could base future comparability determinations on a foreign jurisdiction's regulatory standards, rather than regulatory requirements.

Building on its historical outcomes-based approach to comparability determinations, the CFTC would consider all the relevant elements of a foreign jurisdiction's regulatory regime. The CFTC explains that this would allow it to factor all such relevant elements without precluding a finding of comparability if the foreign regulatory regime does not address one of more of such element. Under the Proposal, the CFTC could give greater weight to elements it deems to be more critical than others, and give less weight to those elements that it deems to be less critical. The CFTC may consider any factor it deems appropriate when making future comparability determinations. For example, the CFTC may consider whether a foreign regulatory authority has issued a reciprocal comparability determination with respect to the Commission's corresponding regulatory requirements. Other factors may include the following:

- The scope and objectives of the relevant foreign jurisdiction's regulatory standards
- Comparable regulatory outcomes to the Commission's corresponding requirements
- The ability of the relevant regulatory authority or authorities to supervise and enforce compliance with the relevant foreign jurisdiction's regulatory standards

- Whether the relevant foreign jurisdiction's regulatory authorities have entered into a memorandum of understanding or similar cooperative arrangement with the Commission regarding the oversight of swap entities

The CFTC could, on its own initiative, undertake a comparability determination to further international comity. Parties that could request the CFTC to issue a comparability determination with respect to some or all of the Group A and Group B Requirements include (1) swap entities that are eligible for substituted compliance, (2) trade associations whose members are such swap entities, or (3) foreign regulatory authorities that have direct supervisory authority over such swap entities and are responsible for administering the relevant swap standards in the foreign jurisdiction.

RECORDKEEPING

In addition to the foregoing, the Proposal contemplates imposing a new recordkeeping requirement on SDs and MSPs. Specifically, SDs and MSPs would be required to create and maintain records of their compliance with the Proposal, allowing compliance officers and regulators to assess compliance with the Proposal.

WHAT'S NEXT

The Proposal's 60-day comment period ends on March 9, 2020. Market participants should immediately begin to analyze the new definitions and requirements to determine how the Proposal would impact their swap dealing activities and provide meaningful comments to help the CFTC shape the proposal in a way that achieves the Commission's regulatory initiatives in a manner that is not overly burdensome to market participants.

Contacts

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