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SEC Proposes Cross-Border Security-Based Swap Rules and Guidance

On May 23, 2013, the Securities and Exchange Commission (SEC) published in the Federal Register proposed rules and guidance for applying Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) to cross-border security-based swap (SB Swap) activities and non-U.S. persons (the Release). The SEC's cross-border approach has some significant differences from the Commodity Futures Trading Commission's (CFTC) approach.¹ For one, the SEC's Release gives more fulsome treatment of the cross-border application of Dodd-Frank than the Commodity Futures Trading Commission (CFTC) has yet provided, including a proposal for a detailed process for substituted compliance with foreign regulatory systems.² In addition, whereas the SEC has proposed rules and regulations specific to cross-border activities, the CFTC has only proposed interpretive guidance on the extra-territorial reach of the CFTC's jurisdiction under the Dodd-Frank Act.

Recognizing the broad impact that cross-border application of Dodd-Frank will have, the SEC also reopened for 60 days the comment periods for several outstanding Dodd-Frank rulemakings that concern SB Swaps.³ By contrast, most of the CFTC's swaps rules are already final. Different approaches between the SEC and CFTC cross-border proposals create additional uncertainty as to what actions the CFTC will take, if any, when its cross-border exemptive order expires on July 12, 2013. Unless the CFTC further delays the implementation of its cross-border guidance, there will be a limited window of time for the two agencies to coordinate on cross-border issues and harmonize requirements for participants in both the swaps and SB Swaps markets.⁴

Substituted Compliance

The SEC recognized that in a global market, market participants that engage in cross-border SB Swaps may be subject to conflicting or duplicative compliance obligations. Thus, the SEC proposed a process for permitting compliance with requirements in a comparable foreign financial regulatory system to substitute for compliance with four categories of SEC requirements, including: 1) requirements applicable to or relating to registered SB Swap dealers, 2) regulatory reporting and public dissemination requirements for SB Swaps, 3) clearing requirements for SB Swaps and 4) trade execution requirements for SB Swaps.⁵

1 The CFTC proposed guidance on the cross-border application of its swap regulations in July 2012. See Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 Fed. Reg. 41214 (July 12, 2012). The CFTC generally takes the approach that any swap with at least one U.S. person counterparty would be subject to the CFTC's regulations. On December 21, 2012, the CFTC issued a final exemptive order providing time-limited relief from compliance with certain swap regulations to certain market participants and a time-limited definition of a "U.S. person." The relief expires on July 12, 2013. See Final Exemptive Order Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 858 (Jan. 7, 2013); see also the Jan. 11, 2013 Skadden Client Alert: CFTC Issues Final Exemptive Order on Cross-Border Application of Certain Swap Regulations, available at <http://www.skadden.com/insights/cftc-issues-final-exemptive-order-cross-border-application-certain-swap-regulations>.

2 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, 78 Fed. Reg. 30968, 31085 (May 23, 2013).

3 *Id.* at 31127.

4 The comment period for the SEC's proposed cross-border rules and guidance will be open until August 21, 2013.

5 78 Fed. Reg. at 30975 n.43.

Notably, the SEC said it would focus on regulatory outcomes rather than a rule-by-rule comparison and accept differences between regulatory regimes that accomplish comparable regulatory outcomes. For example, if a foreign jurisdiction's regulations are comparable to SEC requirements in three of the four categories, the SEC would permit an entity to comply with the foreign jurisdiction's three categories of requirements, and only require the entity to comply with the SEC rules for the fourth category for which comparable regulations do not exist.⁶ The SEC would be able to impose conditions or make a substituted compliance determination limited to certain requirements.⁷

Proposed Definition of 'US Person'

The SEC proposed to define a U.S. person to mean⁸:

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

The SEC's U.S. person definition is generally consistent with the U.S. person definition in the CFTC's time-limited exemptive order,⁹ although there are some differences. For example, the CFTC's time-limited definition specifies the circumstances in which estates and pension plans would be considered U.S. persons while the SEC's definition does not.¹⁰

Partnerships, Corporations and Other Entities

An entity's U.S. person status would be determined at the entity level and apply to the entire entity. A "U.S. person" would include any foreign trading desk, foreign office or foreign branch of an entity that is organized under U.S. law or whose principal place of business is located in the United States.¹¹ A "foreign branch" would be a branch of a U.S. bank that: (i) is located outside the United States, (ii) operates for valid business reasons and (iii) is engaged in the business of banking and is subject to substantive banking regulation in the jurisdiction where located.¹²

6 *Id.* at 30975.

7 *Id.* at 31088. The SEC also proposed procedures regarding requesting a substituted compliance determination, such as requiring information regarding applicable foreign regulatory requirements and the methods by which a foreign regulator monitors and enforces those requirements and providing for a hearing or publishing the application in the Federal Register and inviting public comment.

8 The SEC proposed to define a U.S. person in the Release differently than it did in Regulation S (Reg. S). *See* 17 C.F.R. §§ 230.901-905. The SEC explained that a safe harbor for securities issuers under Reg. S for certain offshore securities offerings entails different policy considerations than in the SB Swap context. Title VII, on the other hand, intends to capture the entity that actually bears the risks arising from SB Swap transactions, rather than the person involved in making the investment decision. Because the policy goals of Reg. S and Title VII differ, the SEC has proposed to apply different definitions of a U.S. person in each context. 78 Fed. Reg. at 31007.

9 *See supra* note 1.

10 *See* 78 Fed. Reg. at 858.

11 The SEC did not define "principal place of business," but asked for comment on whether this phrase should mean the location of the personnel who direct, control or coordinate the SB Swap activities of the entity consistent with the focus in the Investment Advisers Act of 1940. 78 Fed. Reg. at 30999-00.

12 *Id.* at 31002.

However, a foreign affiliate or foreign subsidiary of a U.S. person would not be a U.S. person because it has a distinct legal status from its U.S. parent.¹³ In defining U.S. person, the SEC proposed generally that the term “person” means a “separately organized legal person.”¹⁴ Therefore, within affiliated groups of companies, the designation of one affiliate would not be “imputed to other non-dealer affiliates or the group as a whole.”¹⁵ Likewise, the SEC said that “a foreign subsidiary of a U.S. person would not be a U.S. person by virtue of its relationship with its U.S. parent.”¹⁶

Accounts of US Persons

The account of a U.S. person would be considered a U.S. person.¹⁷ Whether the entity at which the account is held or maintained is a U.S. person would be irrelevant. The account of a non-U.S. person held or maintained at an entity that is a U.S. person would not be considered a U.S. person.¹⁸ The SEC’s approach to accounts mirrors the treatment of accounts in the CFTC’s time-limited definition of U.S. person.¹⁹

Proposed Definition of ‘Transactions Conducted Within the United States’

The SEC proposed new definitions for “transactions conducted within the United States” and “transactions conducted through a foreign branch.” The definitions are designed to identify aspects of SB Swap activities that should, in the SEC’s view, trigger SB Swap Dealer (SBSD) registration requirements.²⁰ The proposed definition of a “transaction conducted within the United States” means any SB Swap that is solicited, negotiated, executed or booked within the United States, by or on behalf of either counterparty to the transaction. The location, domicile or residence status of either counterparty would be irrelevant to whether that transaction was conducted in the United States.²¹

For an SB Swap to qualify as a “transaction conducted through a foreign branch,” the branch must be the named counterparty to the transaction and the transaction must not be “solicited, negotiated, or executed by a person within the United States on behalf of the foreign branch or its counterparty.”²² Accordingly, a “transaction conducted through a foreign branch” of a U.S. bank would not be a “transaction conducted within the United States.”²³

The SEC said that submitting a transaction for clearing in the United States or reporting a transaction to a SB Swap Data Repository in the United States would not independently cause a transaction to be conducted in the United States because these activities are not indicative of SB Swap dealing.²⁴

13 *Id.* at 30997.

14 *Id.* at 30993.

15 *Id.* at 30993 n.252.

16 *Id.* at 30997. The SEC also specifically excluded the following international organizations from the definition of a U.S. person: the International Monetary Fund, the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the United Nations, and their agencies and pension plans, and any other similar international organizations, their agencies and pension plans. *Id.* at 30998.

17 The CFTC’s time-limited exemptive order similarly defines a U.S. person to include an individual or joint account if its beneficial owner falls within the scope of the CFTC’s temporary U.S. person definition. 78 Fed. Reg. at 858.

18 78 Fed. Reg. at 30997.

19 See 78 Fed. Reg. at 858.

20 78 Fed. Reg. at 31000.

21 *Id.* at 30999-00.

22 *Id.* at 31002.

23 *Id.* at 31000.

24 *Id.*

Similarly, activities related to collateral management (e.g., exchange of margin payments) would not cause a transaction to be conducted within the United States. However, if a non-U.S. person solicits, negotiates or executes a transaction with another non-U.S. person within the United States, such activity would amount to the transaction being “conducted within the United States” even if that transaction is ultimately booked by the two non-U.S. entities outside of the United States.²⁵

Noting that there could be “operational difficulties” in determining whether a counterparty is conducting a transaction within the United States, the SEC proposed to allow a party to rely on a representation received from a counterparty indicating that a given transaction “is not solicited, negotiated, executed, or booked within the United States by or on behalf of such counterparty.”²⁶ The SEC did not further define the terms “solicited,” “negotiated” or “executed,” in this context. Accordingly, an entity with offices in multiple jurisdictions may face its own internal operational difficulties in determining whether it can make this representation.

Proposed Cross-Border Approach for Registered Entities

The SEC proposed cross-border rules and guidance regarding entities that would have to be registered with the SEC — namely, SB Swap Dealers (SBSDs), Major SB Swaps Participants (MSBSPs), SB Swap Data Repositories (SB SDRs), SB Swap Execution Facilities (SB SEFs) and SB Swap clearing agencies.

SBSDs

1. Registration

Under the SEC’s rules, a person with SB Swap dealing activity exceeding a *de minimis* threshold notional amount of activity must register with the SEC as an SBSBD.²⁷

a) *Application of De Minimis Threshold*

Consistent with the statutory definition of an SBSBD, in determining whether SBSBD registration is required, the SEC focuses on an entity’s SB Swap dealing activity conducted within the SEC’s jurisdiction, as opposed to the risks that such entity may pose to the financial markets.²⁸ Under the SEC’s proposal, a U.S. person “would be required to count all of its SB swap transactions (including transactions conducted through a foreign branch), conducted in a dealing capacity, toward the *de minimis* threshold” for SBSBD registration.²⁹ This principle would apply regardless of the location of the transactions or the status of the U.S. person’s counterparty as a U.S. person.³⁰

A non-U.S. person would have to count toward its *de minimis* threshold for SBSBD registration its dealing activity in: (i) SB Swaps with U.S. persons (other than transactions with foreign branches of U.S. persons, provided the transactions are not “conducted within the

25 *Id.* at 31000-01.

26 *Id.* at 31001. A party may rely on a representation to that effect from its counterparty, provided the party does not know the representation is inaccurate. *Id.* at 31003. Alternatively, the SEC asked commenters whether parties should be required to exercise reasonable standards of care and due diligence. *Id.* at 31002.

27 See 17 C.F.R. § 240.3a71-1; see also Section 3(a)(71)(D) of the Securities Exchange Act.

28 78 Fed. Reg. at 30988.

29 *Id.* at 30989-90.

30 *Id.* at 30994.

United States”); and (ii) SB Swap “transactions conducted within the United States.”³¹ The SEC’s proposed approach may capture more SB Swap dealing activity in certain circumstances than the CFTC’s proposed approach for swap dealing activity. For example, a U.S. branch of a non-U.S. bank would be required to count all of its SB Swap dealing activities with both U.S. and non-U.S. persons toward the SBSB *de minimis* threshold. Conversely, a U.S. branch of a non-U.S. bank would only be required to count its swap dealing activity with U.S. persons toward the CFTC swap dealer *de minimis* threshold.

b) *Aggregation of Affiliates’ SB Swap Dealing Activity*

The SEC’s proposal applies cross-border considerations to the aggregation principles for SB Swap dealing previously adopted in joint rules with the CFTC.³² The SEC proposed that under the jointly-adopted aggregation principles, for purposes of determining whether the *de minimis* threshold for SBSB registration is exceeded, a person must aggregate (1) all SB Swap dealing positions of its U.S. affiliates (including “transactions conducted through a foreign branch”), and (2) the SB Swap dealing positions of its non-U.S. affiliates (i) with U.S. counterparties (other than transactions with foreign branches of U.S. persons, provided the transaction is not “conducted within the United States”), or (ii) that are “transactions conducted within the United States.” A person would not be required to aggregate the positions of an affiliate that is (1) operationally independent, and (2) registered as an SBSB.³³ “Operationally independent” would mean that the affiliates have separate sales, trading, operations and risk management functions.³⁴

c) *Treatment of Guarantees and Inter-Affiliate Transactions*

Unlike the CFTC’s approach, a non-U.S. person would not have to aggregate its SB Swap dealing activity outside of the United States with a non-U.S. person where the transaction is guaranteed by a U.S. person.³⁵ However, such transactions would be subject to regulatory reporting and, in certain cases, real-time reporting.³⁶ Furthermore, the U.S. guarantor could become an MSBSP by virtue of the guarantee. An SB swap guaranteed by a U.S. person may also be subject to the clearing and trade execution mandates.³⁷

The SEC proposed that inter-affiliate SB Swap transactions should not be counted toward the *de minimis* threshold.³⁸ Rather, “there must be an independent basis for requiring a person to register as [an SBSB] that is unrelated to its inter-affiliate transactions.”³⁹

31 *Id.* at 30990.

32 See Further Definition of “Swap Dealer,” “SB Swaps Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant,” 77 Fed. Reg. 30596, 30624 (May 23, 2012).

33 78 Fed. Reg. at 31005.

34 *Id.*

35 *Id.* at 31006. The term “guarantee” refers to a contractual agreement pursuant to which one party to a SB Swap transaction has recourse to its counterparty’s parent, other affiliate or guarantor with respect to the counterparty’s obligations owed under the transaction. *Id.* at 31032 n.626.

36 *Id.* at 30990 n.203 and 205.

37 *Id.* at 30990 n.203.

38 This position reiterates the SEC’s and CFTC’s jointly-adopted final rulemaking defining “swap dealer” and “SB Swap dealer,” in which the SEC and CFTC adopted rules providing that swaps between majority-owned affiliates would not count toward the *de minimis* threshold. See 77 Fed. Reg. at 30624-25.

39 78 Fed. Reg. at 31006.

2. Regulation

The SEC proposed to categorize SBSB regulatory requirements as either transaction-level or entity-level requirements. The SEC's proposed cross-border application of these requirements is discussed further below.

In addition to satisfying applicable transaction-level and entity-level requirements, prior to registration, non-U.S. SBSBs would be required to certify and obtain a legal opinion that the firm could, as a matter of law, provide the SEC with prompt access to books and records and submit to onsite SEC examinations.⁴⁰

a) *Transaction-Level Requirements*

According to the SEC, SBSB transaction-level requirements are requirements that “primarily focus on protecting counterparties.” The SEC noted that external business conduct standards⁴¹ and collateral segregation⁴² are the most significant transaction-level requirements.⁴³ In general, the SEC proposes that the external business conduct standards would not apply to the “Foreign Business” of SBSBs. Generally, “Foreign Business” means SB swap transactions between (1) a non-U.S. SBSB and a non-U.S. person conducted outside the U.S. or (2) a foreign branch of a U.S. SBSB and a non-U.S. person conducted outside the United States.⁴⁴ All other transaction-level requirements would apply to foreign and U.S. registered SBSBs. In particular, collateral segregation requirements would apply to SBSBs either broadly or narrowly depending on whether (1) the SBSB also is an SEC-registered broker-dealer or foreign bank with a branch or agency in the U.S. and (2) the SB Swap is cleared or uncleared.⁴⁵

b) *Entity-Level Requirements*

The SEC said that “entity-level requirements ... primarily address concerns relating to the [SBSB] as a whole.”⁴⁶ The SEC would consider the following to be entity-level requirements: margin, capital, risk management, recordkeeping, regulatory reporting, internal systems and controls, diligent supervision, conflicts of interest requirements, chief compliance officer designation, inspection and examination, and licensing and disqualification of associated persons.⁴⁷ The SEC did not propose to relieve foreign SBSBs from these entity-level requirements but may permit substituted compliance in certain circumstances.⁴⁸ The SEC proposed that the appropriate time for a foreign SBSB to inform the SEC of its intent to be subject to substituted compliance is when it applies for SBSB registration.⁴⁹ Thus, foreign SBSBs would have to provide additional information when applying to register with respect to their home country regulatory regime.⁵⁰

40 *Id.* at 31015.

41 *See* Section 15F(h) of the Securities Exchange Act of 1934 (Exchange Act).

42 *See* Section 3E of the Exchange Act.

43 78 Fed. Reg. at 31010.

44 *Id.* at 31008 n.374.

45 *Id.* at 31016.

46 *Id.* at 31011.

47 *Id.* at 31011-16.

48 *Id.* at 31024.

49 *Id.* at 31027.

50 *Id.* at 31028.

MSBSPs

1. Registration

Under the SEC's rules, the MSBSP definition is triggered by SB Swap-related trading that exceeds specified threshold notional amounts.⁵¹ A person meeting the MSBSP definition must register as such with the SEC.⁵²

a) MSBSP Calculation

In contrast to the focus on transactions in the SEC's jurisdiction for SB Swap dealing activity, the SEC's cross-border approach for MSBSPs is aimed at identifying SB Swap-related activities that would pose a high degree of risk to the U.S. financial system.⁵³ As proposed, a U.S. person would be required to consider all of its SB Swap positions, regardless of the location of the transaction or the counterparty's status as a U.S. person, in calculating whether it satisfies the MSBSP definition.

A non-U.S. person would calculate only its SB Swap positions with U.S. persons. This means, for example, that a non-U.S. person would need to consider its SB Swap positions with any branches or offices of a U.S. person that are located in a foreign jurisdiction, including foreign branches of U.S. banks.⁵⁴

b) Treatment of Guarantees and Inter-Affiliate Transactions

Given the SEC's different cross-border considerations for SBSBs and MSBSPs, the SEC proposed to treat SB swaps guaranteed by U.S. persons differently for MSBSPs than for SBSBs in a cross-border context. A U.S. person would be required to include in its MSBSP calculations any SB Swaps in which it has guaranteed a non-U.S. person, regardless of whether the underlying SB Swap was entered into with a U.S. person or a non-U.S. person counterparty. A non-U.S. person guarantor would be required to include in its MSBSP calculations any guaranteed SB Swap transactions of a U.S. person, as well as any guaranteed SB Swap transactions of another non-U.S. person if the underlying SB Swap was entered into with a U.S. person counterparty.⁵⁵

A guarantor of SB Swap transactions would not be required to attribute to itself the SB Swaps of the guaranteed person if the guaranteed person is subject to capital regulation by the SEC or the CFTC (*i.e.*, as a swap dealer, SB Swap dealer, major swap participant, MSBSP, futures commission merchant or broker-dealer), is a U.S. entity regulated as a bank in the U.S., or is subject to capital standards adopted by its home country supervisor that are consistent in all respects with the Capital Accord of the Basel Committee on Banking Supervision.⁵⁶ Consistent with the position taken by the CFTC and the SEC in the adoption of the MSBSP definition, a non-U.S. person could exclude SB Swaps with majority-owned affiliates from MSBSP calculations.⁵⁷

51 17 C.F.R. § 240.3a67-1.

52 15 U.S.C. § 78o-10(a)(2) (Section 15F of the Securities Exchange Act).

53 78 Fed. Reg. at 31029.

54 This differs from the SEC's proposed approach for scoping in the SB Swap dealing activity of a non-U.S. person, which would exclude any SB Swap dealing activity with foreign branches of U.S. banks. *Id.* at 30989.

55 *Id.* at 31032-33.

56 *Id.* at 31033.

57 *Id.* at 30687.

2. Regulation

Under the SEC's proposed approach, a registered non-U.S. MSBSP would not be subject to external business conduct standards with respect to its SB Swap transactions with other non-U.S. persons.⁵⁸ Additionally, if a registered non-U.S. MSBSP is not also registered with the SEC as a broker-dealer, it would not have to comply with the requirements concerning segregation of collateral with respect to SB Swap transactions with other non-U.S. persons.⁵⁹ The SEC also would allow a non-U.S. MSBSP to delegate operational compliance with transaction-level requirements to any entities within the MSBSP's structure that directly are party to the SB Swap transaction.⁶⁰ Unlike its approach for SBSBs, the SEC did not propose any substituted compliance procedures for non-U.S. MSBSPs or any other relief from the entity-level MSBSP requirements.⁶¹

SB SDRs

The SEC provides guidance on the circumstances under which a non-U.S. person performing the functions of an SB SDR would be required to register with the SEC as an SB SDR. A non-U.S. person that performs SB SDR functions within the United States for purposes other than Dodd-Frank compliance could elect not to register with the SEC as an SDR (the SB SDR Exemption) if each regulator with supervisory authority over the non-U.S. person has entered into a supervisory and enforcement memorandum of understanding or similar arrangement with the SEC that addresses (i) the confidentiality of data, (ii) access by the SEC to such data and (iii) any other matters determined by the SEC.⁶² However, reporting SB Swaps to a person electing the SB SDR Exemption would not fulfill Dodd-Frank reporting requirements. In other words, a non-U.S. person performing functions of an SB SDR still would need to be an SEC-registered SB SDR in order for reporting to that non-U.S. person to satisfy SB Swaps reporting obligations under Dodd-Frank.

With respect to an earlier SEC proposal that an SB SDR notify the SEC of a regulator's request for information,⁶³ the SEC now says that it would be sufficient for an SB SDR to notify the SEC of the initial request of a regulator, provided that the SB SDR maintains records of the initial and all subsequent requests.

In addition, the SEC responded to regulators' concerns about its previously proposed requirement that the requesting regulator must indemnify the SB SDR and the SEC for expenses arising from litigation relating to information provided by the SB SDR. The SEC noted that in certain circumstances, certain domestic and foreign regulatory authorities could obtain SB SDR-maintained data without an indemnification by obtaining the data directly from the SEC pursuant to Sections 21(a) and 24(c) of the Exchange Act. The SEC also proposed an exemption from the indemnification requirement where: the regulator's requests to the SB SDR is limited to SB Swaps information needed to fulfill a regulatory mandate or legal responsibility; the regulator's request only pertains to a person or financial product that is subject to the requesting regulator's jurisdiction, supervision or oversight; and the requesting regulator has entered into a supervisory and enforcement memorandum of understanding or other arrangement with the SEC that addresses confidentiality and any other matters as determined by the SEC.

58 *Id.* at 31035.

59 *Id.*

60 *Id.* at 31034.

61 *Id.* at 31035-36.

62 *Id.* at 31042 and n.724.

63 *Id.* at 31040-41.

SB SEFs

The SEC proposed to clarify when a foreign SB Swap market would have to register with the SEC as an SB SEF. The following circumstances would cause a foreign SB Swap market that meets the statutory definition of SB SEF, found in Section 3(a)(77) of the Exchange Act,⁶⁴ to have to register as an SB SEF:

- providing U.S. persons or other persons located in the U.S. “with the direct ability to trade or execute SB Swaps on the foreign SB Swap market by accepting bids and offers made by one or more participants on the foreign SB Swap market”; or
- granting “membership or participation in the foreign SB Swap market to U.S. persons, or non-U.S. persons located in the United States, which would provide such persons with the ability to directly execute or trade SB Swaps by accepting bids and offers made by one or more participants on the foreign SB Swap market.”⁶⁵

The SEC also would take other factors into consideration, including whether the foreign SB Swap market initiates contact with U.S. persons or non-U.S. persons located in the U.S. to facilitate trading. A U.S. person trading on a foreign SB Swap market through a non-U.S. person would not necessarily trigger SB SEF registration so long as the SB Swap market did not initiate contact with the U.S. person.⁶⁶

The SEC would consider, in limited circumstances, exempting a foreign SB Swap market from registration if the market is subject to comparable, comprehensive substituted compliance in its home jurisdiction.⁶⁷

SB Swap Clearing Agencies

The SEC also addressed when foreign SB Swap clearing agencies would have to register with the SEC. Under the SEC’s proposed interpretive guidance, a foreign SB Swap clearing agency would have to register as a clearing agency with the SEC where i) it performs the functions of a central counterparty (CCP) for SB Swaps,⁶⁸ ii) within the United States. The SEC interprets the “within the United States” condition as being satisfied where the foreign SB Swap clearing agency provides such CCP services to a member that is a U.S. person. This registration requirement would not necessarily be triggered where a U.S. person chooses to clear transactions at the foreign SB Swap clearing agency on an indirect basis through a correspondent clearing arrangement with a non-U.S. member of the clearing agency.⁶⁹

The SEC would consider exempting a foreign SB Swap clearing agency from registration where that foreign SB Swap clearing agency is subject to comparable, comprehensive supervision and regulation by appropriate government authorities in its home jurisdiction. As an alternative to granting a registration exemption, the SEC may consider proposing rules specific to foreign SB Swap clearing agencies that are registered with the SEC.⁷⁰

64 The statute defines an SB SEF as “a trading system or platform in which multiple participants have the ability to execute or trade [SB Swaps] by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that (A) facilitates the execution of [SB Swaps] between persons and (B) is not a national securities exchange.”

65 78 Fed. Reg. at 31054.

66 *Id.* at 31055.

67 *Id.* at 31056.

68 The SEC notes that CCP functions include, among others: the extinguishing of a SBS contract between two counterparties and the associated novation of it with two new contracts between the CCP and each of the two original counterparties; the assumption of counterparty credit risk of members of the CCP through the novated SBS contracts; and the calculation and collection of initial and variation margin during the life of the SBS contract. *Id.* at 31038.

69 *Id.* at 31039.

70 *Id.* at 31039-40.

Proposed Cross-Border Approach for Mandatory Clearing and Execution of SB Swaps

The SEC proposed to apply the mandatory clearing requirement⁷¹ and mandatory trade execution requirement⁷² to i) any person that engages in an SB Swap transaction in which at least one of the counterparties to the transaction is a U.S. person, or a non-U.S. person whose performance under the SB Swap is guaranteed by a U.S. person, and ii) any person that engages in an SB Swap transaction conducted within the United States.

The SEC proposed two exceptions to the mandatory clearing requirement and the mandatory trade execution requirement. Under the first exception, if the SB Swap transaction is not a “transaction conducted within the United States,” the mandatory clearing requirement and mandatory trade execution requirement would not apply if (a) one counterparty to the transaction is a foreign branch of a U.S. bank or a non-U.S. person whose performance under the SB Swaps is guaranteed by a U.S. person; and (b) the other party to the transaction is a non-U.S. person whose performance under the SB Swaps is not guaranteed by a U.S. person, and who is not a foreign SBSB. Under the second exception, if the SB Swaps transaction is a “transaction conducted within the United States,” the mandatory clearing requirement and mandatory trade execution requirement would not apply if neither counterparty to the transaction is a U.S. person or a foreign SBSB, and neither counterparty’s performance under the SB Swap is guaranteed by a U.S. person.⁷³

Recognizing that U.S. counterparties may sometimes seek to clear an SB Swap through a clearing agency that is neither SEC-registered nor exempt from registration, the SEC proposed to exempt persons from the clearing mandate if the relevant transaction is submitted to a foreign clearing agency that is the subject of a substituted compliance determination by the SEC.

The SEC’s proposal would limit substituted compliance requests to foreign clearing agencies that have no U.S. person members or activities in the United States.⁷⁴ In making a substituted compliance determination, the SEC would consider: the scope and objectives of the applicable foreign jurisdiction’s regulatory requirements, the effectiveness of the foreign regulator’s supervisory compliance program, the enforcement authority exercised by the foreign regulator and the foreign jurisdiction’s overall regulatory framework.⁷⁵ Notably, the SEC relied on its exemptive authority in Section 36 of the Exchange Act instead of proposing a specific rule related to substituted compliance for clearing.

The SEC proposed to allow a person subject to the mandatory trade execution requirement to execute that transaction on an SB Swap market that is neither registered under the Exchange Act nor exempt from registration if the SEC determines that SB Swap market is subject to comparable, comprehensive supervision and regulation by a foreign financial regulatory authority.⁷⁶ For a SB Swap market

71 *Id.* at 31098. Section 3C(a)(1) of the Exchange Act provides that it is unlawful for any person to engage in an SB Swap that the SEC has determined should be cleared unless that person submits the SB Swap for clearing. An SB Swap subject to this mandatory clearing requirement must be cleared at a clearing agency that is either registered with the SEC or exempt from registration.

72 Section 3C(h)(1) of the Exchange Act requires SB Swaps that are subject to the clearing requirement under Section 3C(a)(1) to be executed on an exchange or an SB Swap execution facility. An SB Swap that is not subject to the mandatory clearing requirement is not subject to the mandatory trade execution requirement. 78 Fed. Reg. at 31082.

73 78 Fed. Reg. at 31078-31080 (proposal for mandatory clearing requirement), 31082-83 (proposal for mandatory trading requirement).

74 78 Fed. Reg. at 31098.

75 *Id.*

76 *Id.* at 31099.

for which the SEC has made such a substituted compliance determination, substituted compliance would only be available when: (i) at least one counterparty is either a non-U.S. person or foreign branch of a U.S. bank; and (ii) the SB swap is not solicited, negotiated or executed by a person within the United States on behalf of such counterparty.⁷⁷

Proposed Cross-Border Approach for SB Swaps Reporting

Under the SEC proposal, a direct or indirect counterparty to an SB Swap would be subject to the SB Swaps reporting rules (242.900-242.911) if the counterparty is a U.S. person, an SBSB or MSBSP, or a direct or indirect counterparty to “a transaction conducted within the United States.”⁷⁸ Similar to CFTC swaps reporting requirements, the SEC would assign the duty to report to an SB SDR according to a hierarchy that favors the side of the transaction with a person registered with the SEC as an SBSB or MSBSP (if any) or alternatively, a U.S. person.⁷⁹ Similar principles would apply to determining whether SB Swaps, including any cross-border inter-affiliate’s SB Swaps, would need to be reported to an SB SDR⁸⁰ or be subject to SEC public dissemination requirements.⁸¹

In certain instances, a reporting side could satisfy regulatory reporting and public dissemination obligations through substituted compliance. Relevant factors for determining substituted compliance would include (i) the scope and objectives of the relevant foreign regulatory requirements, (ii) the effectiveness of the supervisory compliance program administered and (iii) the enforcement authority exercised to support oversight of the regulatory reporting and public dissemination system for SB Swaps. The SEC would not issue a substituted compliance order for a particular jurisdiction unless, among other factors, the SEC has direct electronic access to the SB Swaps data held by a repository or the foreign regulator and requirements similar to the SEC’s apply with respect to the regulatory and public reporting of SB Swaps data and the maintenance thereof. If the SEC issues a substituted compliance order, the regulatory reporting and public dissemination requirements for a SB Swap could be

⁷⁷ *Id.*

⁷⁸ *Id.* at 31065 n.911. A “direct counterparty” would be a person that enters directly with another person into a SB Swap. An “indirect counterparty” would be a person that guarantees the performance of a direct counterparty to a SB Swap or otherwise provides recourse to the other side for the failure of the direct counterparty to perform any obligation under the SBS (indirect counterparty). *Id.* at 31077 n.1012, 31059.

⁷⁹ *Id.* at 31059 n.871. The reporting side hierarchy would be as follows:

- (i) if a side includes a SBSB, that side would be the reporting side (and if both sides include an SBSB, the sides would select the reporting side);
- (ii) if both sides include a MSBSP, the sides would select the reporting side;
- (iii) if one side includes a MSBSP and the other side does not include a SBSB or MSBSP, the side with the MSBSP would be the reporting side;
- (iv) if neither side includes a SBSB or MSBSP and only one side includes a U.S. person, the side with the U.S. person would be the reporting side; and
- (v) if neither side includes a SBSB or MSBSP and either both sides include a U.S. person or neither side includes a U.S. person, the sides would select the reporting side. *Id.* at 31066.

⁸⁰ An SB Swap, including any cross-border inter-affiliate’s SB Swap, would need to be reported to an SB SDR if: (i) the SB Swap is a “transaction conducted within the United States;” on either side of the transaction; (ii) there is a direct or indirect counterparty that is a U.S. person; (iii) there is a direct or indirect counterparty that is a SBSB or MSBSP on either side of the transaction or (iv) the SB Swap is cleared through a clearing agency having its principal place of business in the United States. *Id.* at 31195.

⁸¹ A SB Swap would be subject to SEC public dissemination requirements if: (i) the SB Swap is a “transaction conducted within the United States;” (ii) there is a direct or indirect counterparty that is a U.S. person on each side of the transaction; (iii) at least one direct counterparty is a U.S. person (except in the case of a transaction conducted through a foreign branch); (iv) one side includes a U.S. person and the other side includes a non-U.S. person that is a SBSB or (v) the SB Swap is cleared through a clearing agency having its principal place of business in the United States. *Id.*

satisfied through substituted compliance with the relevant foreign jurisdiction's requirements if at least one direct counterparty is either a non-U.S. person or a foreign branch, and the SB Swap is not solicited, negotiated or executed by a person within the United States on behalf of such counterparty.⁸²

Proposed Cross-Border Approach for Antifraud Authority

Although the SEC did not use the Release to propose specific rules regarding its anti-fraud enforcement authority, the SEC discussed the breadth of its enforcement authority in light of Dodd-Frank Section 929P(b), which added provisions to the federal securities laws addressing the SEC's cross-border antifraud enforcement authority. The SEC explained that through these Dodd-Frank amendments, Congress attempted to eliminate any uncertainty caused by the U.S. Supreme Court's decision in *Morrison v. National Australia Bank*, which held that the antifraud prohibitions in Section 10(b) of the Exchange Act only applied to transactions in securities listed on domestic exchanges and domestic transactions in other securities.⁸³ Accordingly, the SEC said that now, irrespective of whether the securities at issue are traded on a domestic exchange or the transactions occur in the United States, the SEC can apply its antifraud provisions to (1) conduct within the United States that constitutes significant steps in furtherance of the antifraud violation and (2) conduct outside the United States that has a foreseeable substantial effect within the United States.⁸⁴

82 *Id.* at 31093.

83 *Id.* at 31101.

84 *Id.* at 31101-02.