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The CFTC's Final Cross-Border Swaps Rule

November 16, 2020

The Commodity Futures Trading Commission (the CFTC) adopted a final rule (the Cross-Border Rule)[1] that will determine the cross-border application of certain of the CFTC's swaps regulations for swap dealers and major swap participants (MSPs), including applicable registration thresholds. The Cross-Border Rule became effective November 13, 2020.

The Cross-Border Rule reflects the CFTC's interpretation of Section 2(i) of the Commodity Exchange Act (the CEA). Section 2(i) provides that the CEA's swaps provisions "shall not apply to activities outside the United States" unless the activities "have a direct and significant connection with activities in, and effect on, commerce of the United States" or contravene CFTC rules or regulations "necessary or appropriate to prevent the evasion" of the CEA's swaps provisions.

We summarize below the key consequences of the Cross-Border Rule and provide an overview of how it will operate, including the manner in which it uses newly defined terms and categorizes newly designated groups of swaps requirements. In Annex A, we provide further analysis of the Cross-Border Rule's consequences and operation.

Key Consequences of the Cross-Border Rule

- *Reach: Significant Though Limited.* The Cross-Border Rule addresses the cross-border application of only Part 23 of the CFTC's swap rules — which impose certain obligations on swap dealers and MSPs. Moreover, the Cross-Border Rule addresses only a portion, albeit a majority, of Part 23. Thus, the Cross-Border Rule does not address the application of the CFTC's uncleared swaps margin rules or requirements that apply regardless of the registration status of the parties to swap transactions, such as clearing and trade execution.
- *Relationship to 2013 Cross-Border Guidance.* With respect to the requirements that the Cross-Border Rule does address, it will supersede the CFTC's cross-border interpretive guidance and policy statement published in 2013 (the Cross-Border Guidance),[2] which set forth the CFTC's initial approach to cross-border swaps regulation.[3] Accordingly, the Cross-Border Guidance, including its "U.S. person" definition, continues to be relevant for certain purposes.
- *Relationship to Cross-Border Margin Rule.* In many respects, the Cross-Border Rule will extend the approach that the CFTC took when it adopted its 2016 cross-border rule relating to the

application of margin requirements for uncleared swaps (the Cross-Border Margin Rule).[4] The Cross-Border Rule does not supersede the Cross-Border Margin Rule, which will continue to apply to the cross-border application of the CFTC's uncleared swaps margin rules.

- *Relationship to SEC Cross-Border Rules.* The Cross-Border Rule will harmonize, to a significant degree, the CFTC's cross-border approach to swap dealer regulation with the cross-border approach of the Securities and Exchange Commission (the SEC) to security-based swap dealer regulation; the latter is reflected in the SEC's cross-border security-based swap rules (the SEC Cross-Border Rules).[5]
- *Treatment of Collective Investment Vehicles Under the "U.S. Person" Definition.* An investment fund, commodity pool, and other collective investment vehicle (each a CIV) will be considered a "U.S. person" under the Cross-Border Rule only if it is organized in the United States or has a U.S. principal place of business. In contrast to the approach taken in the Cross-Border Guidance, non-U.S.-organized CIVs will not be "U.S. persons" under the Cross-Border Rule merely because a majority of their investors are U.S. persons. Thus, a non-U.S. dealer will be permitted to trade with such non-U.S. CIVs without counting the resulting trades against the dealer's *de minimis* registration threshold (below which the dealer's swap dealing transactions must remain for the dealer to avoid swap dealer registration with CFTC). However, non-U.S. CIVs must still be counted if they have a U.S. principal place of business. Under the Cross-Border Rule (as under the Cross-Border Guidance), a non-U.S. CIV's principal place of business is the location from which its manager primarily directs, controls, and coordinates the CIV's investment activities. Thus, non-U.S.-organized funds with U.S. managers will generally continue to be deemed "U.S. persons" for purposes of applying the *de minimis* registration threshold. Moreover, the Cross-Border Guidance's definition of "U.S. person" will have continued relevance to the CFTC's requirements related to swap clearing, trade execution, real-time public reporting, large trader reporting, swap data reporting and swap data recordkeeping (which the Cross-Border Guidance defines as Non-Registrant Requirements).
- *Treatment of Non-U.S. Subsidiaries of U.S. Corporate Groups: "Significant Risk Subsidiaries."* The Cross-Border Rule reflects a further step in the evolution of how the CFTC addresses non-U.S. subsidiaries of corporate groups that have U.S. parents. In that regard, that Cross-Border Rule defines the term "significant risk subsidiary" (SRS) and uses the term in place of "affiliate conduit" (as defined in the Cross-Border Guidance) and "foreign consolidated subsidiary" (FCS**)** (as defined not only in the Cross-Border Margin Rule but also in the CFTC's older 2016 cross-border rule proposal).[6]
- *Narrowing of "Guarantee" Definition.* The Cross-Border Rule, like the Cross-Border Guidance, treats non-U.S. persons much like U.S. persons if they trade swaps with the benefit of guarantees provided by U.S. persons. However, the Cross-Border Rule's definition of "guarantee" is narrower than the related definition of "guarantee" in the Cross-Border Guidance. The new definition generally conforms both to the definition of "guarantee" in the Cross-Border Margin Rule and to the SEC Cross-Border Rules' concept of "guarantee" (which is a term used in, though

not defined in, the SEC Cross-Border Rules). Thus, unlike the Cross-Border Guidance definition, the Cross-Border Rule does not treat as a "guarantee" a keepwell that does not provide swap counterparties direct rights of recourse against the keepwell provider.

- *Swap Dealer de Minimis Threshold.* The Cross-Border Rule's treatment of SRSs and guarantees is particularly evident in its approach to the swap dealer *de minimis* threshold for swap dealer registration. Although the Cross-Border Rule's approach in that regard is generally consistent with the approach to the *de minimis* threshold in the Cross-Border Guidance, the two approaches diverge because of how the Cross-Border Rule addresses SRSs and "guarantees."
- *Setting Aside the Concept of "ANE Transactions."* The Cross-Border Rule eschews a concept that had been proposed as a key element of the CFTC's initial approach to the cross-border application of its swap requirements: "ANE Transactions." ANE Transactions are swap transactions of non-U.S. swap dealers that are "arranged, negotiated or executed" by personnel in the United States. Instead, the Cross-Border Rule focuses on whether swap transactions of non-U.S. swap dealers are "booked" in a "U.S. branch" of the non-U.S. swap dealer.
- *Designation of New Transaction Categories in Connection With Cross-Border Relief.* The Cross-Border Rule addresses various swaps requirements differently, depending on how the Cross-Border Rule groups those requirements. The Cross-Border Rule does not expressly rely on the Cross-Border Guidance's categories of "entity-level transaction requirements" and "transaction-level requirements." However, the Cross-Border Rule's categories — Group A, B, and C requirements — echo, though only in part, those categories from the Cross-Border Guidance.
- *Complexity Remains When Determining Whether Cross-Border Relief Is Available.* In formulating exceptions for certain swap dealer requirements in certain cross-border contexts, the Cross-Border Rule relies on a complex set of detailed conditions.

Overview of the Cross-Border Rule

The Cross-Border Rule operates through four basic mechanisms:

- It establishes defined terms, some of which are similar to defined terms in the Cross-Border Guidance and the Cross-Border Margin Rule, and some of which are new.
- It sets forth how a non-U.S. dealer must count swap dealing transactions when determining whether the non-U.S. dealer exceeds the CFTC's swap dealer *de minimis* threshold, thus triggering a requirement to register with the CFTC as a swap dealer. It similarly addresses the cross-border application of the CFTC's MSP registration thresholds.[7]
- It creates exceptions from certain swap dealer requirements under the CFTC's swap rules. In doing so, it categorizes those requirements into three groups:
    - Group A requirements (certain requirements applicable on a swap-dealer-wide basis)
    - Group B requirements (certain requirements applicable on a transaction-by-transaction basis)

    - Group C requirements (certain requirements related to business conduct standards)

  The three groups do not cover all the requirements imposed on swap dealers under the CFTC's swap rules, and thus the cross-border treatment of other swap requirements will remain unchanged by the Cross-Border Rule.

- It sets forth circumstances in which substituted compliance will be permitted for swap dealers also subject to non-U.S. swap regulatory regimes with respect to which the CFTC has issued favorable comparability determinations.

The Cross-Border Rule does not supersede the Cross-Border Margin Rule, which will continue to apply to the cross-border application of the CFTC's uncleared swaps margin rules. It also does not supersede those portions of the Cross-Border Guidance that set forth the CFTC's views on the application of Non-Registrant Requirements (as defined in the Cross-Border Guidance): requirements related to swap clearing, trade execution, real-time public reporting, large trader reporting, swap data reporting, and swap data recordkeeping. The related rules, unlike the Part 23 rules addressed by the Cross-Border Rule, do not apply exclusively to swap dealers and MSPs. The disconnect between the Cross-Border Rule and the Non-Registrant Requirements may result, among other things, in different "U.S. person" definitions being applicable in different contexts.

Defined Terms

The principal defined terms in the Cross-Border Rule are

- U.S. person
- guarantee
- significant risk subsidiary
- swap entity
- foreign branch (and swap conducted through a foreign branch)
- U.S. branch (and swap booked in a U.S. branch)
- foreign-based swap
- foreign counterparty

In Annex B, we set forth the definitions for those terms (and certain component definitions). Below we briefly summarize the function that each defined term serves in the Cross-Border Rule.

U.S. Person

The Cross-Border Rule uses "U.S. person" in two principal ways:

- U.S. persons must count all swap dealing transactions when applying the CFTC's *de minimis* exception for swap dealer registration; in contrast, non-U.S. persons are permitted, in many circumstances, to count swap dealing transactions only with counterparties that are U.S. persons.

- Relief from Group A, B, and C requirements turns, in significant part, on whether a swap dealer is a U.S. person or a non-U.S. person.

Guarantee; Guaranteed Entity

A non-U.S. person whose swaps are guaranteed by a U.S. person is often treated under the Cross-Border Rule as though it were a U.S. person. Thus, for example, a non-U.S. swap dealer that is guaranteed by a U.S. person is treated much the same as a U.S. swap dealer.

Although the Cross-Border Rule does not define or use the term “Guaranteed Entity,” the accompanying Adopting Release does so:

> For ease of understanding, the discussion in this release uses the term “Guaranteed Entity” to refer to a non-U.S. person whose swaps are guaranteed by a U.S. person, but only with respect to the swaps that are so guaranteed.[8]

We use the term similarly in Annex A.

Significant Risk Subsidiary; Other Non-U.S. Person

Similarly, when a non-U.S. person is an SRS — that is, a subsidiary of a U.S. parent, where both the parent and the subsidiary meet certain criteria related to their size and thus market significance — it may be treated under the Cross-Border Rule as though it were a U.S. person (particularly where the SRS is itself a swap dealer).

Although the Cross-Border Rule does not define or use the term “Other Non-U.S. Person,” the Adopting Release does do so:

> [T]his release uses the term “Other Non-U.S. Person” to refer to a non-U.S. person that is neither a Guaranteed Entity nor a significant risk subsidiary.

We use the term similarly in Annex A.

Swap Entity

The Cross-Border Rule uses “swap entity” to refer to both swap dealers and MSPs. As noted above, although the Cross-Border Rule addresses swap dealers and MSPs, this Sidley Update focuses solely on swap dealers.

In this Sidley Update:

- The term “swap dealer” refers to a swap dealer that is registered as such with CFTC, unless the context indicates otherwise.
- The term “U.S. swap dealer” means a swap dealer that is a U.S. person, and “non-U.S. swap dealer” means a swap dealer that is not a U.S. person.

- The term “dealer,” without being designated as a “swap dealer,” means an entity that engages in any amount of swap dealing activity (and that thus may or may not be required to register with the CFTC as a swap dealer).

Foreign-Based Swap; Foreign Branch (and Swap Conducted Through a Foreign Branch); U.S. Branch (and Swap Booked in a U.S. Branch)

The Cross-Border Rule provides relief — in the form of substituted compliance and/or exceptions to certain requirements — by referring, in certain provisions, to “foreign-based swaps.” That term is defined differently for U.S. swap dealers and non-U.S. swap dealers. For U.S. swap dealers, a “foreign-based swap” means any swap “conducted through a foreign branch.” For non-U.S. swap dealers, a “foreign based swap” means all swaps except any “swap booked in a U.S. branch.” Accordingly, the term “foreign branch” is defined only by reference to U.S. swap dealers, and the term “U.S. branch” is defined only by reference to non-U.S. swap dealers.

Foreign Counterparty

Similarly, the Cross-Border Rule provides relief — in the form of substituted compliance and/or exceptions to certain requirements — by referring, in certain provisions, to “foreign counterparties.” That term is defined differently for counterparties that are U.S. persons and those that are non-U.S. persons. U.S. persons are “foreign counterparties” for swap transactions only when their non-U.S. branches enter into the transactions in a manner that satisfies the definition of a “swap conducted through a foreign branch.” All non-U.S. persons are “foreign counterparties” except when they “book swaps in a U.S. branch.”

Requirement Groups

As noted above, the Cross-Border Rule creates three new categories of swap requirements, which it then uses for various purposes. We summarize the new categories here.

Group A Requirements

The Group A requirements are entity-specific (rather than transaction-specific) requirements related to

- chief compliance officers
- risk management
- swap data recordkeeping
- antitrust considerations[9]

Group B Requirements

The Group B requirements are transaction-specific (rather than entity-specific) requirements related to

- swap trading relationship documentation
- portfolio reconciliation and compression

- trade confirmation
- daily trading records[10]

Group C Requirements

The Group C requirements are transaction-specific (rather than entity-specific) requirements related to

- business conduct standards governing the conduct of swap dealers when dealing with their swap counterparties[11]
- the rights of a swap dealer's counterparties to require segregation of initial margin posted to the swap dealers (where segregation is not otherwise required pursuant to the CFTC's rules)[12]

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[1] See CFTC, *Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, Cross-Border Rule*, 85 Fed. Reg. 56924 (September 14, 2020) (the Adopting Release), available at https://www.cftc.gov/sites/default/files/2020/09/2020-16489a.pdf?utm_source=govdelivery.

[2] See CFTC, *Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations*, 78 Fed. Reg. 45292 (July 26, 2013), available at http://www.gpo.gov/fdsys/pkg/FR-2013-07-26/pdf/2013-17958.pdf. *See* Sidley Update, *CFTC Adopts Final Cross-Border Guidance and Exemptive Order; Announces "Path Forward" with EU* (July 19, 2013), available at https://www.sidley.com/en/insights/newsupdates/2013/07/cftc-adopts-final-crossborder-guidance-and-exemptive-order-announces-path-forward-with-eu.

[3] See Adopting Release at 56931 ("The Cross-Border Rule supersedes the Commission's policy views as set forth in the Guidance with respect to its interpretation and application of section 2(i) of the CEA and the swap provisions addressed in the [Cross-Border] Rule").

[4] See CFTC, *Margin Requirements for Non-cleared swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements; Agency Information Collection Activities: Proposed Collection, Comment Request: Cross-Border Rule, Margin Requirements for Non-cleared swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements; Cross-Border Rule and Notice*, 81 Fed. Reg. 34817 (May 31, 2016), available at https://www.gpo.gov/fdsys/pkg/FR-2016-05-31/pdf/2016-12612.pdf; see also Sidley Update, *CFTC Adopts Cross-Border Margin Rule for Non-Cleared Swaps* (August 4, 2016), available at http://www.sidley.com/news/2016-08-04-derivatives-update.

[5] Unlike the CFTC's approach in the Cross-Border Guidance, the SEC's approach to the cross-border reach of its security-based swaps has resulted in a series of rulemakings: Each time the SEC has adopted final rules implementing regulation of security-based swaps, it has also adopted companion cross-border rules. *See* Annex A note 1.

[6] See CFTC, *Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants; Cross-Border Rule, Interpretations*, 81 Fed. Reg. 71946 (October 18, 2016) (the 2016 Cross-Border Proposal), available at http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-24905a.pdf.

[7] The Cross-Border Rule's treatment of MSP registration thresholds is similar to its treatment of registration thresholds for swap dealers. This Sidley Update does not separately address MSPs because of the similarity of treatment and the fact that, as of the date hereof, there are no registered MSPs.

[8] Adopting Release at 56941.

[9] The Group A Requirements are the requirements set forth in the following provisions of the CFTC's rules: Sections 3.3, 23.201, 23.203, 23.600, 23.601, 23.602, 23.603, 23.605, 23.606, 23.607, and 23.609.368. In addition, Section 45.2(a) is included to the

extent it duplicates Section 201 of Part 23. See Adopting Release at 56966 (“The Commission is making this addition to clarify that, to the extent the same substantive recordkeeping requirement is included in both §§ 23.201 and 45.2(a), each is a group A requirement . ”).

[10] The Group B Requirements are the requirements set forth in Sections 23.202, 23.501, 23.502, 23.503, and 23.504.

[11] See CFTC Rules, Sections 23.400-451; see also Adopting Release at 56967:

> Under these rules, SDs and MSPs are required to, among other things, conduct due diligence on their counterparties to verify eligibility to trade (including eligible contract participant (“ECP”) status), refrain from engaging in abusive market practices, provide disclosure of material information about the swap to their counterparties, provide a daily mid-market mark for uncleared swaps, and, when recommending a swap to a counterparty, make a determination as to the suitability of the swap for the counterparty based on reasonable diligence concerning the counterparty.

[12] The Group C Requirements are the requirements set forth in Sections 23.400-451 and 23.700-704.

Annex A

Discussion of
Key Consequences of the Cross-Border Rule

In this Annex A, we further discuss key consequences of the Cross-Border Rule, which were summarized above.

"U.S. Person" Definition — A Narrowing for Purposes of Part 23

The Cross-Border Rule's definition of "U.S. person" is identical to the SEC Cross-Border Rules' definition,[1] and it is substantially the same as the Cross-Border Margin Rule's definition.[2] However, the Cross-Border Rule's definition of "U.S. person" is applicable only to the CFTC's Part 23 rules, which apply to swap dealers in their capacity as such. Thus, for example, the new definition applies when non-U.S. dealers apply the *de minimis* threshold for swap dealer registration; it also applies for purposes of determining when swap dealers are relieved from the Group A, B, and C requirements. In contrast, the definition does not apply, for example, when applying the rules addressing swap clearing, mandatory trade execution requirements, or real-time reporting.

The Cross-Border Rule's definition of "U.S. person," unlike the Cross-Border Guidance's related definition, does not include a majority U.S. ownership prong for CIVs. That prong of the Cross-Border Guidance's definition covers any CIV that is majority-owned by one or more U.S. persons (subject to a limited exception for non-U.S. CIVs publicly offered only to non-U.S. persons and not offered to U.S. persons). In the Adopting Release, the CFTC explained why it did not include that prong in the Cross-Border Rule:

> Similar to the SEC, the Commission is of the view that including majority-owned CIVs within the definition of "U.S. person" for the purposes of the Cross-Border Rule would

[1] The SEC's approach to the cross-border reach of its security-based swaps has resulted from a series of rulemakings. Each time that the SEC has adopted final rules to implement the regulation of security-based swaps, it has also adopted companion cross-border rules. The SEC's definition of "U.S. person" is set forth in Exchange Act Rule 3a71-4(a)(4), which was adopted as part of the first of the following rulemakings (which together reflect different aspects of the SEC Cross-Border Rules):

- *Application of ''Security-Based Swap Dealer'' and ''Major Security-Based Swap Participant'' Definitions to Cross-Border Security-Based Swap Activities*; Cross-Border Rule; Republication, available at https://www.govinfo.gov/content/pkg/FR-2014-08-12/pdf/R1-2014-15337.pdf.
- *Security-Based Swap Transactions Connected With a Non-U.S. Person's Dealing Activity That Are Arranged, Negotiated, or Executed by Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent; Security-Based Swap Dealer De Minimis Exception*, Cross-Border Rule, available at https://www.govinfo.gov/content/pkg/FR-2016-02-19/pdf/2016-03178.pdf.
- *Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants*, Cross-Border Rule, available at https://www.govinfo.gov/content/pkg/FR-2016-05-13/pdf/2016-10918.pdf.
- *Cross-Border Application of Certain Security-Based Swap Requirements*; Cross-Border Rules; Guidance, available at https://www.govinfo.gov/content/pkg/FR-2020-02-04/pdf/2019-27760.pdf.

[2] In the Adopting Release, the CFTC stated that it views the "U.S. person" definition in the Cross-Border Margin Rule to largely encompass the same universe of persons as the Cross-Border Rule's definition. See Adopting Release at 56933.

> likely cause more CIVs to incur additional programmatic costs associated with the relevant Title VII requirements and ongoing assessments, while not significantly increasing programmatic benefits given that the composition of a CIV's beneficial owners is not likely to have significant bearing on the degree of risk that the CIV's swap activity poses to the U.S. financial system.[3]

This represents one of several places in the Cross-Border Rule where the CFTC focused on systemic risk that swap dealer activity may create within the United States rather than focusing on risks that end users may face when they trade with swap dealers.

The Cross-Border Rule's definition of "U.S. person" retains a "principal place of business" prong. In that regard, the Cross-Border Rule is consistent with all the Cross-Border Guidance, the Cross-Border Margin Rule, and the SEC Cross-Border Rules. In the Adopting Release, the CFTC provided guidance regarding how it will interpret that prong: "With the exception of externally managed entities, ... [the CFTC] is of the view that for most entities, the location of these officers, partners, or managers generally corresponds to the location of the person's headquarters or main office."[4] As to externally managed entities, the CFTC explained, in a manner consistent with the Cross-Border Guidance, that

> determining the principal place of business of a CIV, such as an investment fund or commodity pool, may require consideration of additional factors beyond those applicable to operating companies. The Commission interprets that, for an externally managed investment vehicle, this location is the office from which the manager of the vehicle primarily directs, controls, and coordinates the investment activities of the vehicle.[5]

In the Adopting Release, the CFTC contrasted the Cross-Border Rule's definition of "U.S. person" with the Cross-Border Margin Rule's definition of the same term and their respective principal-place-of-business prongs. Under the Cross-Border Margin Rule, the CFTC considers two different concepts in determining the principal place of business of a CIV, namely the location of senior personnel responsible for either

> (1) the formation and promotion of the CIV; or (2) the implementation of the CIV's investment strategy are located in the United States, depending on the facts and circumstances that are relevant to determining the center of direction, control, and coordination of the CIV.[6]

The CFTC stated in the Adopting Release that the second of those two concepts is consistent with CFTC's approach to the principal-place-of-business prong in the Cross-Border Rule. As to the first concept in the Cross-Border Margin Rule's definition, the CFTC explained that the CFTC

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[3] Adopting Release at 56935.

[4] Adopting Release at 56936.

[5] Adopting Release at 56936.

[6] Adopting Release at 56937.

> does not believe that activities such as formation of the CIV, absent an ongoing role by the person performing those activities in directing, controlling, and coordinating the investment activities of the CIV, generally will be as indicative of activities, financial and legal relationships, and risks within the United States of the type that Title VII is intended to address as the location of a CIV manager.[7]

The CFTC then stated that it may "consider amending the 'U.S. person' definition in the Cross-Border Margin Rule in the future."[8]

Other differences between the "U.S. person" definitions in the Cross-Border Guidance and the Cross-Border Rule include these:

- The "U.S. person" definition in the Cross-Border Rule does not include unlimited liability companies that are majority-owned by U.S. persons.
- The "U.S. person" definition in the Cross-Border Rule expressly excludes 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 its agencies and pension plans, and any other similar international organizations and their agencies and pension plans.

One additional observation regarding the "U.S. person" definitions in the Cross-Border Rule and the Cross-Border Guidance: The "U.S. person" definition in the Cross-Border Guidance is "non-exhaustive" — that is, the prongs of that definition are introduced textually by the phrase "to include, but not be limited to."[9] In contrast, like the self-contained definition set forth in the Cross-Border Margin Rule, the definition of "U.S. person" in the Cross-Border Rule is limited to the enumerated clauses of the definition.[10]

In recognition of the differences between the "U.S. person" definitions under the Cross-Border Rule, the Cross-Border Margin Rule, and the Cross-Border Guidance and the burdens associated with collecting updated status representations, the Cross-Border Rule provides time-limited relief, until December 31, 2027, permitting a person to continue to classify its counterparties as "U.S. persons" based on representations made pursuant to the "U.S. person" definition contained in Cross-Border Margin Rule or the Cross-Border Guidance, but only to the extent that the representations were obtained prior to the effective date of the Cross-Border Rule (i.e., November 13, 2020).

[7] Adopting Release at 56937.

[8] Adopting Release at 56937.

[9] See Cross-Border Guidance at 45316 ("In summary, for purposes of the application of CEA section 2(i), the Commission will interpret the term "U.S. person" generally to include, but not be limited to ...").

[10] See Adopting Release at 56936 ("Unlike the non-exhaustive 'U.S. person' definition provided in the Guidance, the definition of 'U.S. person' is limited to persons enumerated in the rule consistent with the Cross-Border Margin Rule and the SEC Cross-Border Rule.").

Significant Risk Subsidiaries — Their Advent and the Demise of Affiliate Conduits and Foreign Consolidated Subsidiaries

Since adopting the Cross-Border Guidance in 2013, the CFTC has grappled with the cross-border treatment of non-U.S. subsidiaries and other non-U.S. affiliates of U.S. persons for purposes of its swap dealer rules, particularly for purposes of the *de minimis* threshold for swap dealer registration. The Cross-Border Guidance introduced the concept of an "affiliate conduit" (or "conduit affiliate").[11] The 2016 Cross-Border Proposal introduced the concept of an FCS. Now, following its introduction earlier this year when the Cross-Border Rule was proposed (the 2020 Rule Proposal),[12] the concept of an SRS will be a feature of the CFTC's approach to cross-border swap regulation. Indeed, the Cross-Border Rule does not refer either to affiliate conduits or to FCSs.[13]

As noted (see "Defined Terms — Significant Risk Subsidiary"), an SRS is treated the same as a U.S. person for several purposes under the Cross-Border Rule.

As described in greater detail in Annex B, an SRS is a non-U.S. person that

- is part of large corporate group (at least $50 billion in global consolidated assets) headed by a U.S. parent and
- represents 5% of the group's equity capital or 10% of the group's revenue or assets.

A non-U.S. person that satisfies those two conditions is nonetheless excluded from the SRS definition if it is subject to

- consolidated supervision and regulation by the Federal Reserve as a subsidiary of a U.S. bank holding company or
- capital standards and oversight by the non-U.S. person's home country regulator that are consistent with the Basel III capital and margin requirements for uncleared swaps in respect of which the CFTC has issued a comparability determination.

In contrast:

- An FCS — as defined in the Cross-Border Margin Rule and as proposed to be defined in the 2016 Cross-Border Proposal — is a non-U.S. person in which an ultimate U.S. parent entity has a controlling financial interest as defined in, and which the ultimate U.S. parent thus consolidates under, U.S. generally accepted accounting principles.

[11] As noted in the 2016 Cross-Border Proposal, the Cross-Border Guidance "uses the terms 'conduit affiliate' and 'affiliate conduit' interchangeably." 2016 Cross-Border Proposal at 71956 note 82.

[12] See CFTC, *Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, Notice of Proposed Rulemaking*, 85 Fed. Reg. 953 (January 8, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-01-08/pdf/2019-28075.pdf.

[13] The Adopting Release does not address FCSs substantively. As to affiliate conduits, the Adopting Release states that the "concept was not ... included in the proposed regulations because the concerns posed by a conduit affiliate were intended to be addressed through the proposed definition and regulation of SRSs." Adopting Release at 56942.

- An “affiliate conduit” is a non-U.S. person that
    - is majority-owned by a U.S. person, is controlled, controlling, or under common control with a U.S. person, and/or is consolidated with a U.S. person and
    - in the regular course of business, engages in swaps with non-U.S. third-parties 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-parties to its U.S. affiliates.[14]

Accordingly, a non-U.S. subsidiary of a U.S. parent will not qualify as an SRS (though it could have qualified as an affiliate conduit or FCS) if

- it fails to meets certain minimum size requirements, with respect both to the size of its U.S. parent and to the relative size of the subsidiary as a part of the U.S. parent’s group or
- it is supervised and regulated by the Federal Reserve (as part of a bank holding company) or, in effect, by an equivalent supervisor/regulator in its home jurisdiction.

However, a non-U.S. subsidiary may qualify as an SRS, though it could not have qualified as an affiliate conduit, even if it does not to act as a trading “conduit” for its U.S. affiliate(s).

These differences — between SRSs, on the one hand, and FCSs and affiliate conduits, on the other — reflect the CFTC’s focus, in framing the Cross-Border Rule, on systemic risk.[15] Where a non-U.S. subsidiary of a U.S. parent is not considered a source of such risk — either because its parent’s size, or its own relative size in the parent’s corporate group, is too small, or because it is supervised and regulated either as a member of a banking holding company (or its equivalent in it home jurisdiction) — it will not be categorized as an SRS (and thus generally will be treated like non-U.S. persons that do not have U.S. parents). Accordingly, however, it will be considered a source of systemic risk if it is large enough and not separately regulated, even if it does not act as a trading conduit for any U.S. affiliate.

Guarantees — Keepwells Not Included

Since adopting the Cross-Border Guidance, the CFTC has also grappled, though in fewer iterations, with how to address non-U.S. entities that trade with the benefit of certain kinds of credit support from U.S. persons (typically from a U.S. corporate parent or other U.S. affiliate). The shifting positions have not

[14] The Cross-Border Guidance does not define “affiliate conduit” precisely but instead sets forth the factors above, which are “relevant” to a determination that a non-U.S. person is an “affiliate conduit.” See Cross-Border Guidance at 45359.

[15] See Adopting Release at 56943:

> The Commission’s approach in the Cross-Border Rule ... accounts for the risk that non-U.S. subsidiaries may pose to the U.S. financial system and the ability of large global entities to operate efficiently outside the United States. The Commission’s risk-based approach is embodied in the definition of an SRS, which, as discussed above, captures entities whose obligations under swaps may not be guaranteed by U.S. persons, but nonetheless raise particular supervisory concerns in the United States due to the possible negative effect on their ultimate U.S. parent entities and thus the U.S. financial system.

related to the consequences that result when U.S. credit support is present. Instead, the CFTC's positions have concerned the types of credit support from a U.S. person that are deemed to be a "guarantee" and that thus trigger various consequences.[16]

The Cross-Border Guidance takes an expansive approach to "guarantees." Its concept of "guarantee" covers more than contractual relationships where the guarantor and the beneficiary are in privity:

> Under the [Cross-Border] Guidance, the Commission advised that it would interpret the term "guarantee" generally to include not only traditional guarantees of payment or performance of the related swaps, but also other formal arrangements that, in view of all the facts and circumstances, support the non-U.S. person's ability to pay or perform its swap obligations. The Commission stated that it believed that it was necessary to interpret the term "guarantee" to include the different financial arrangements and structures that transfer risk directly back to the United States.[17]

In contrast, the CFTC took a narrower approach when it adopted the Cross-Border Margin Rule, limiting the definition of "guarantee" to an arrangement pursuant to which one party to a swap has rights of recourse against a guarantor with respect to the parties' rights under the swap.[18] The Cross-Border Rule follows that approach. And the SEC Cross-Border Rules, though they do not define the term "guarantee," use terminology (including the word "guarantee") in a fashion that is similar.[19]

ANE Transactions — Next Stop for the "Elevator Rule"

The CFTC's previous approach to ANE Transactions has been referred to as the "elevator rule." That moniker was based, at least in part, on a comment made by former CFTC Chairman Gary Gensler:

> [A] U.S. swap dealer on the 32nd floor of a New York building and a foreign-based swap dealer on the 31st floor of the same building, have to follow the same rules when arranging, negotiating or executing a swap. One elevator bank ... one set of rules.[20]

That comment related to a footnote in the Cross-Border Guidance and a related CFTC staff advisory. The footnote in the Cross-Border Guidance indicated that "a U.S. branch of a non-U.S. swap dealer or MSP would be subject to Transaction-Level requirements, without substituted compliance available." A few

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[16] See above ("Defined Terms — Guarantee") for a summary of how the term is used in the Cross-Border Rule.

[17] Adopting Release at 56940.

[18] See Cross-Border Margin Rule, 17 C.F.R. 23.160(a)(2).

[19] See, e.g., SEC Cross-Border Rule 3a71–3(b)(1)(iii)(B), which describes certain security-based swap transactions that must be counted by non-U.S. security-based swap dealer for *de minimis* calculation:

> Security-based swap transactions connected with the dealing activity in which such person engages for which the counterparty to the security-based swap has rights of recourse against a U.S. person that is controlling, controlled by, or under common control with the non-U.S. person; for these purposes *a counterparty has rights of recourse against the U.S. person if the counterparty has 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 security-based swap.* (emphasis added)

[20] Gensler, Gary, *Remarks at Swap Execution Facility Conference: Bringing Transparency and Access to Markets* (Nov. 18, 2013), available at http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-152.

months after the Cross-Border Guidance was published (and just before Chairman Gensler made his statement), the staff of the CFTC issued a related advisory (the Staff Advisory) suggesting that transaction-level requirements would apply more broadly: They would apply to non-U.S. swap dealers "regularly using personnel or agents located in the U.S. to arrange, negotiate, or execute a swap with a non-U.S. person."[21] Moreover, in the 2016 Cross Border Proposal, the CFTC proposed to define "ANE Transaction" in a similar manner.[22] And the SEC relied on a similar concept in framing the SEC Cross-Border Rules.[23]

However, when the CFTC published the 2020 Rule Proposal for comment, it withdrew the 2016 Cross-Border Proposal in its entirety.[24] Then, in the Adopting Release, the CFTC stated expressly that "ANE Transactions will not be considered a relevant factor for purposes of applying the Cross-Border Rule."[25] It explained:

> [T]he Commission recognize[s] that a person that, in connection with its dealing activity, engages in market-facing activity using personnel located in the United States is conducting a substantial aspect of its dealing business in the United States and is subject to U.S. law. But, because the transactions involve two non-U.S. persons, and the financial risk of the transactions lies primarily outside the United States, the Commission also recognized that it must consider the extent to which the underlying regulatory objectives of the Dodd-Frank Act would be advanced in light of other policy considerations, including undue market distortions and international comity, when making a determination of the extent to which the Dodd-Frank Act swap requirements should apply to ANE Transactions.[26]

Thus, as discussed further below, the Group B and Group C requirements will be applied, on a cross-border basis, without reference, per se, to the location of personnel who arrange, negotiate, and execute swap transactions. Whether a given swap transaction is "booked" in a "U.S. branch" of a non-U.S. swap dealer will be the primary criterion that determines when the Cross-Border Rule provides relief to non-U.S. swap dealers and when it does not. Moreover, the CFTC decided not to require that a non-U.S. dealer count ANE Transactions when applying the *de minimis* test for swap dealer registration. That decision is contrary to the SEC's decision to require that security-based swap dealers count ANE

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[21] CFTC Staff Advisory No. 13-69, Applicability of Transaction-Level Requirements to Activity in the United States (Nov. 14, 2013), available at http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/13-69.pdf.

[22] The 2016 Cross-Border Proposal did not include the word "regularly," which qualified the staff's position under the advisory. However, the 2016 Cross-Border Proposal made clear that incidental contacts with the United States by swap dealer personnel would not trigger ANE Transaction status. See 2016 Cross-Border Proposal at 71953, note 66 ("The Proposed Rule would accordingly not capture the activities of personnel assigned to a non-U.S. location if such personnel are only incidentally present in the United States when they arrange, negotiate, or execute a transaction (e.g., an employee of a non-U.S. person happens to be traveling within the United States to attend a conference). Nor would the Proposed Rule include a transaction solely on the basis that a U.S.-based attorney is involved in negotiations regarding the terms of the transaction").

[23] See SEC Cross-Border, Rule 3a71–3(b)(1)(iii)(C).

[24] See Adopting Release at 56926.

[25] Adopting Release at 56961.

[26] Adopting Release at 56961.

Transactions for purposes of applying the SEC's *de minimis* test for security-based swap dealer registration. The CFTC explained why it decided to take a contrary position in framing the Cross-Border Rule:

> [T]he Commission sees little value in requiring counting of ANE Transactions when, if such counting resulted in SD registration, such ANE Transactions would not be subject to most of the SD requirements. ANE Transactions by definition are swaps between non-U.S. persons, the risk of which lies primarily outside of the U.S., and which, in accordance with the Commission's determination above and the regulatory exceptions discussed immediately below, are generally excepted from the group B and C requirements.[27]

However, the CFTC did not exclude the possibility that the concept of ANE Transactions could nonetheless apply when the CFTC addresses the cross-border application of other swap requirements:

> In this rulemaking, the Commission is addressing the issue [related to ANE Transactions] with respect to the group B and group C requirements; the Commission intends to address the issue with respect to the remaining Transaction-Level Requirements (the "Unaddressed TLRs") in connection with future cross-border rulemakings relating to such requirements.[28]

Having stated as much, the CFTC nonetheless confirmed that until it engages in such further rulemaking, it "will not consider, as a matter of policy, a non-U.S. swap entity's use of their personnel or agents located in the United States to 'arrange, negotiate, or execute' swap transactions with non-U.S. counterparties for purposes of determining whether Unaddressed TLRs apply to such transactions."[29] It also noted that the CFTC staff was withdrawing the Staff Advisory.[30]

Swap Dealer de Minimis Threshold — The Consequence of the Cross-Border Rule's Treatment of SRSs and its Definition of "Guarantee"

In most respects, the Cross-Border Rule's cross-border approach to the *de minimis* threshold for swap dealer registration is comparable to the Cross-Border Guidance's approach. The similar respects may be outlined as follows:

- Dealers that are U.S. persons must count all dealing swaps without regard to the identity of their counterparty.

[27] Adopting Release at 56963.

[28] Adopting Release at 56963. The Transaction-Level Requirements are "(1) required clearing and swap processing; (2) margining (and segregation) for uncleared swaps; (3) mandatory trade execution; (4) swap trading relationship documentation; (5) portfolio reconciliation and compression; (6) real-time public reporting; (7) trade confirmation; (8) daily trading records; and (9) external business conduct standards." Adopting Release at 56961 note 341.

[29] Adopting Release at 56963.

[30] The Staff Advisory was formally withdrawn in CFTC Letter No. 20-21 (July 23, 2020), available at https://www.cftc.gov/csl/20-21/download.

- Dealers that are non-U.S. persons that are Guaranteed Entities[31] must also count all dealing swaps without regard to the identity of their counterparty.
- Dealers that are Other Non-U.S. Persons — that is, neither Guaranteed Entities nor SRSs — are required to count dealing swaps, including swaps booked in U.S. branches,[32] only where the counterparties are
    - U.S. persons, unless the U.S. person is itself a swap dealer (i.e., is registered with the CFTC) and the swap in question is conducted through its foreign branch[33] or
    - Guaranteed Entities, unless (i) the Guaranteed Entity is, or is affiliated with, a swap dealer (i.e., registered with the CFTC) and, in the case of an affiliate, is itself below the *de minimis* threshold, or (ii) the Guaranteed Entity's swaps are subject to a guarantee by a U.S. person that is a non-financial entity.[34]

  However, in any such case, there is an exception for any swap that
    - the dealer anonymously enters into on a designated contract market (or DCM), a swap execution facility (or SEF) that is registered or exempt from registration, or a registered foreign board of trade (or FBOT) and
    - is cleared through a derivatives clearing organization (or DCO) that registered or exempt from registration.[35]
- Dealers must aggregate their dealing swaps and those of affiliated persons[36] (U.S. and non-U.S.) to the extent that the affiliated persons are themselves required to include those swaps

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[31] The Cross-Border Guidance addresses "guaranteed affiliates." However, for most practical purposes, the use of that term — as contrasted with the term "Guaranteed Entity" in the Adopting Release and the related terms of the Cross-Border Rule — makes no difference. See Adopting Release at 56986 note 541 ("While the Cross-Border Rule and the Guidance treat swaps involving Guaranteed Entities in a similar manner, ...").

[32] A dealing swap does is not counted merely because it is booked in a U.S. branch of a non-U.S. dealer. See Adopting Release at 56953:

> [T]he Commission is not requiring a U.S. branch of an Other Non-U.S. Person to count all of its swap dealing transactions in its SD threshold calculation, as if they were swaps entered into by a U.S. person. Rather, a U.S. branch is required to count swaps pursuant to the requirements for Other Non-U.S. Persons (e.g., count swaps with U.S. persons, Guaranteed Entities subject to certain exceptions, etc.). Additionally, an Other Non-U.S. Person is not required to include in its SD de minimis threshold calculation dealing swaps booked in a U.S. branch of a counterparty, unless that swap has to be counted pursuant to other requirements of this Cross-Border Rule.

[33] See Adopting Release at 56952 ("Allowing a non-U.S. person to exclude swaps conducted through a foreign branch of a registered SD counterparty from its *de minimis* threshold calculation is consistent with the Guidance").

Although this exception is consistent with the Cross-Border Guidance, it is inconsistent with the 2016 Cross-Border Proposal, which would have eliminated the exception. See 2016 Cross-Border Proposal at 71956.

[34] See Adopting Release at 56954; see also Adopting Release at 56954 ("The exceptions are intended to address those situations where the risk of the swap between the non-U.S. person and the Guaranteed Entity is otherwise managed under the Dodd-Frank Act swap regime or is primarily outside the U.S. financial industry").

[35] This exception is modestly expanded from the exception under the Cross-Border Guidance, inasmuch as it covers exempt SEFs and DCOs as well as registered SEFs and DCOs. See Adopting Release at 56956.

[36] "Affiliated Persons" means persons controlling, controlled by, or under common control with one another.

in their own *de minimis* threshold calculations, but any dealing swaps of affiliated persons that are themselves swap dealers (registered with the CFTC) may be excluded from the aggregation. As a consequence:

> U.S. persons and non-U.S. persons in an affiliated group [may] engage in swap dealing activity up to the de minimis threshold. When the affiliated group meets the de minimis threshold in the aggregate, one or more affiliate(s) (a U.S. affiliate or a non-U.S. affiliate) have to register as an SD so that the relevant swap dealing activity of the unregistered affiliates remains below the threshold.[37]

The principal differences between the Cross-Border Rule and the Cross-Border Guidance, as they relate to the *de minimis* threshold, are twofold:

- Because the Cross-Border Rule defines "guarantee" more narrowly than does the Cross-Border Guidance (as discussed), the consequences of a non-U.S. person being a Guaranteed Entity, whether it is a dealer or is simply a counterparty to a dealer (as outlined), are more limited.
- The Cross-Border Rule applies the *de minimis* threshold, in part, by referring to SRSs; in contrast, the Cross-Border Guidance (which is superseded by the Cross-Border Rule in this respect) referred to affiliate conduits. As a consequence, in certain circumstances, the Cross-Border Rule will result in a dealer's being required to count more dealing swaps against its *de minimis* threshold; in other circumstances, the opposite will be the case:
    - Under the Cross-Border Rule, a dealer that is an SRS will be required to count all of its dealing swaps against its threshold. In effect, an SRS will be treated (as to *de minimis* threshold) the same as a market participant that is a U.S. person or Guaranteed Entity. In contrast, under the Cross-Border Guidance, an SRS would not have been required to count dealing transactions with non-U.S. persons unless the SRS was an affiliate conduit — that is, unless it acted as a "conduit" for its U.S. affiliates — or a Guaranteed Entity.
    - When a dealer that is an Other Non-U.S. Person — that is, a non-U.S. person that is neither a Guaranteed Entity nor an SRS — applies the *de minimis* threshold, it is not required to count dealing swaps with counterparties that are mere SRSs under the Cross-Border Rule[38] — or, for that matter, that are mere affiliate conduits under the Cross-Border Guidance. It is required to count dealing swaps with non-U.S. persons only if they are Guaranteed Entities.

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[37] Adopting Release at 156987.

[38] See Adopting Release at 56952. ("[I]t is important to ensure that SRSs, particularly ones that are a commercial or non-financial entity that do not engage in swap dealing activities, continue to have access to swap liquidity from Other Non-U.S. Persons for hedging or other non-dealing purposes").

The SRS provisions of the Cross-Border Rule are intended, in part, to close a "loophole" that was perceived to have arisen when non-U.S. subsidiaries of U.S. banking organizations deguaranteed themselves.[39] Thus, a non-U.S. subsidiary of a U.S. banking organization that is an SRS will be required to count all of its dealing transactions in connection with *de minimis* determinations (whether or not its obligations are guaranteed by a U.S. parent and whether or not it acts as a conduit for its affiliates). However, non-U.S. dealers that are not themselves Guaranteed Entities or SRSs and that wish to remain below the *de minimis* threshold (to avoid swap dealer registration with the CFTC) will not be required to include dealing transactions with an SRS (unless the SRS is also a Guaranteed Entity).

Categories A, B, and C — Covering Certain Entity-Level and Transaction-Level Requirements but Leaving Behind "Unaddressed Requirements"

The Cross-Border Rule does not expressly rely on the Cross-Border Guidance's categories of "entity-level transaction requirements" and "transaction-level requirements." However, the Cross-Border Rule's requirement groups — Groups A, B, and C — echo the Cross-Border Guidance's two categories (and the Adopting Release refers to the earlier two categories in a manner suggesting their continued relevance).

The Group A, B, and C requirements are summarized above (see "Requirement Groups"). Those requirements do not cover the "Unaddressed Requirements," which the Adopting Release defines as requirements related to the following:

- capital adequacy
- clearing and swap processing
- mandatory trade execution
- swap data repository reporting
- large trader reporting
- real-time public reporting[40]

The CFTC stated that it "intends to separately address the cross-border application of" the Unaddressed Requirements.[41] It further clarified that "any no-action relief or guidance that applies to the Unaddressed Requirements will remain effective, and that any no-action letter or guidance not specifically revoked remains in effect."[42]

[39] See Adopting Release at 56952 ("The Commission believes that treating an SRS differently from a U.S. person could create a substantial regulatory loophole, incentivizing U.S. persons to conduct their dealing business with non-U.S. persons through SRSs to avoid application of the Dodd-Frank Act SD requirements.").

[40] See Adopting Release at 56963-64 note 354.

[41] Adopting Release at 56963 note 354.

[42] Adopting Release at 56980-81.

Group A Requirements — Relief in the Form of Substituted Compliance

The Group A requirements are a subset of the "entity-level requirements" as defined in the Cross-Border Guidance. The Cross-Border Rule will permit a non-U.S. swap dealer to satisfy applicable Group A requirements, on an entitywide basis rather than a transaction-by-transaction basis, by complying with the applicable standards of a foreign jurisdiction, if those standards have been the subject of a favorable comparability determination by the CFTC. The CFTC explained that

> the group A requirements, which relate to compliance programs, risk management, and swap data recordkeeping, cannot be effectively applied on a fragmented jurisdictional basis. Accordingly, it is not practical to limit substituted compliance for the group A requirements to only those transactions involving non-U.S. persons.[43]

The Cross-Border Rule sets forth the procedures and standards by which the CFTC will make its comparability determinations. The standard of review "emphasizes a holistic, outcomes-based approach."[44] The CFTC

> may find a foreign jurisdiction's standards comparable if, viewed holistically, the foreign jurisdiction's standards achieve a regulatory outcome that adequately serves the same regulatory purpose as the group A or group B requirements as a whole.[45]

Group B Requirements — Relief, Though Not From Complexity

The evolution of the CFTC's approach to cross-border application of it swap rules — first the Cross-Border Guidance, then the Cross-Border Margin Rule, then the 2016 Cross-Border Proposal, and finally the Cross-Border Rule — has resulted in multiple changes to that approach. However, one characteristic has remained constant: complexity. That constant is not surprising. Given the inherent difficulty of applying U.S. swap regulation to a market that is itself complex — and that is, for all intents and purposes, borderless — complexity of any cross-border swap rule, whatever form it takes, is inevitable.

The complexity of the Cross-Border Rule is evident when one scans the matrix in the Adopting Release that summarizes how Group B requirements will apply on a cross-border basis.[46] As described above (see "Requirement Categories — Group B Requirements"), the Group B requirements are certain of the CFTC's "transaction-level requirements" (as that term is defined in the Cross-Border Guidance).

For purposes of the following discussion, we reproduce here the matrix from the Adopting Release, which addresses the applicability of the Group B requirements to different combinations of swap dealers and their counterparties based on their respective statuses under the Cross-Border Rule (e.g., whether one or both is a U.S. person). We have color-coded the matrix for ease of reference below, as we describe certain

[43] Adopting Release at 56977.

[44] Adopting Release at 56977.

[45] Adopting Release at 56978.

[46] See Adopting Release, Table C at 56995-96.

commonalities and differences among how the Cross-Border Rule's Group B exception applies to different combinations of swap dealers and their counterparties:

Swap Entity ↓ / Counterparty →		U.S. Person		Non-U.S. Person			
		Non-Foreign Branch	Foreign Branch	U.S. Branch	Guaranteed Entity	Swap Entity SRS	Other Non-U.S. Person or SRS End User
U.S. Swap Entity	Non-Foreign Branch	Yes	Yes	Yes	Yes	Yes	Yes
	Foreign Branch	Yes[1]	Yes[1] *Sub. Comp. Available*	Yes[1]	Yes[1] *Sub. Comp. Available*	Yes[1] *Sub. Comp. Available*	Yes[1, 2] *Sub. Comp. Available*
Non-U.S. Swap Entity	U.S. Branch	Yes	Yes	Yes	Yes	Yes *Sub. Comp. Available*	Yes *Sub. Comp. Available*
	Guaranteed Entity or SRS	Yes[1]	Yes[1] *Sub. Comp. Available*	Yes[1]	Yes[1] *Sub. Comp. Available*	Yes[1] *Sub. Comp. Available*	Yes[1, 3] *Sub. Comp. Available*
	Other Non-U.S. Person	Yes[1]	Yes[1] *Sub. Comp. Available*	Yes[1]	Yes[1] *Sub. Comp. Available*	Yes[1] *Sub. Comp. Available*	No

[1] The Exchange-Traded Exception is available from certain group B and C requirements for certain anonymous, exchange-traded, and cleared foreign-based swaps between the listed parties.
[2] The Limited Foreign Branch Group B Exception is available from the group B requirements for a foreign branch's foreign-based swaps with a foreign counterparty that is an SRS End User or an Other Non-U.S. Person that is not a swap entity, subject to certain conditions.
[3] The Limited Swap Entity SRS/Guaranteed Entity Group B Exception is available from the group B requirements for the foreign-based swaps of each SRS Swap Entity or Guaranteed Swap Entity with a foreign counterparty that is an SRS End User or an Other Non-U.S. Person that is not a swap entity, subject to certain conditions.

The matrix is a tabular representation of Section 23(e) of the Cross-Border Rule. "Yes" for a given combination (i.e., a given swap dealer and a given counterparty) means that the Group B requirements apply to the swap between the swap dealer and counterparty (subject to certain exceptions and substituted compliance as indicated). "No" means that Group B requirements do not apply because cross-border relief is available.

However, the chart does not use, or otherwise refer to, a key defined term that is used in Section 23(e). That defined term — "foreign-based swap" — should be kept in mind when reading the chart, particularly when reading the two rows shaded in green. The similarity of those two rows belies a key difference between how U.S. swap dealers and non-U.S. swap dealers are treated for purposes of the Group B exceptions.

As described above (and in Annex B), the meaning of "foreign-based swap" differs depending on whether the swap dealer seeking an exception under Section 23(e) is a U.S. person or a non-U.S. person. In a nutshell: It is more difficult for a U.S. swap dealer to enter into a "foreign-based swap" than it is for a non-U.S. swap dealer to do so, and thus the exception from the Group B requirements will, as a practical matter, be more readily available to non-U.S. swap dealers.

A non-U.S. swap dealer achieves the desired end for the exception — that is, entering into a "foreign-based swap" — as long as its swap is not "booked in a U.S. branch." To achieve that end, the non-U.S. swap dealer must simply ensure that the swap is not "reflected in the local accounts of the U.S. branch." Thus, any swap entered into by a non-U.S. person — even a swap that is arranged, negotiated, and executed by personnel in the United States — will qualify as a "foreign-based swap" if it is "booked" offshore. The demise of the ANE Transaction concept is evident here.

In contrast, a U.S. swap dealer must do more than "book" a swap to a "foreign branch" for that swap to be a "foreign-based swap" for the U.S. swap dealer. To be a "foreign-based swap," the swap must be "conducted through a foreign branch" of the U.S. swap dealer. To achieve that end, the swap must not simply be "entered into by a foreign branch" and "reflected in the local accounts of the foreign branch." In addition, the following conditions must be satisfied:

- The foreign branch or another foreign branch is the office through which the U.S. 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 U.S. person is such foreign branch.
- The swap is entered into by such foreign branch in its normal course of business.

Accordingly, even though the chart (and our color-coding) suggests that the swaps of non-foreign branches of U.S. swap dealers and the swaps of U.S. branches of non-U.S. swap dealers are treated similarly, that similarity obscures a key difference in how the exception applies: The U.S. swap dealer benefits from the exception only where the swap in question is entered into in the "normal course of business" of the foreign branch; no such limitation is imposed on non-U.S. swap dealers, which may enter into "foreign-based swaps" by virtue of simply booking the swaps in their non-U.S. branches.

With that key distinction in mind, we summarize below the similarities and differences with respect to how the exception to the Group B requirements applies to different combinations of swap dealers and their counterparties.

- *Green: Little Relief for Swaps Conducted Through/Booked in the United States*
    - A U.S. swap dealer, when it conducts swap transactions through a branch in the United States (i.e., not "through a foreign branch"), is always required to comply with Group B requirements.
    - A non-U.S. swap dealer, when it books a swap in a U.S. branch, is also required to comply with the Group B requirements, subject to one limited exception.

        - That exception applies when the non-U.S. swap dealer's counterparty is a non-U.S. person that is neither a U.S. branch nor a Guaranteed Entity. In that circumstance, substituted compliance will be available (assuming the CFTC has approved the swap dealer's home jurisdiction's related rules for substituted compliance).
        - However, for the reasons discussed above (see "ANE Transactions — Next Stop for the 'Elevator Rule'"), non-U.S. swap dealers that engage in ANE Transactions but do not book the resulting swap in a U.S. branch are not subject to Group B requirements by virtue of the ANE activity. Thus, depending on other circumstances, as discussed below, such non-U.S. swap dealers may be permitted, even for ANE Transactions, to benefit from the Cross-Border Rule's exception to the applicability of Group B requirements as long as the swaps are not "booked" in a "U.S. branch." Because those defined terms are defined with specificity,[47] a range of ANE Transactions may benefit from the Cross-Border Rule's exception.

- *Blue, Purple, and Red: Relief for Swaps Conducted Through/Booked Outside the United States.* Swap dealers — both U.S. and non-U.S. — may receive relief under the Cross-Border Rule when they sufficiently involve their non-U.S. branches (i.e., conduct swaps through "foreign branches" if they are U.S. swap dealers or book swaps in non-"U.S. branches" when they are non-U.S. swap dealers). There are three kinds of such relief.
    - *Blue:* In all such cases of swap dealers operating from branches outside the United States:
        - The Cross-Border Rule provides an exception from certain Group B requirements in connection with certain anonymous, exchange-traded, and cleared foreign-based swaps, even if the swap dealer's counterparty is a U.S. person. The Adopting Release — but not the text of the Cross-Border Rule — refers to this relief as the "Exchange Traded Exception." (As noted below, a similar exception is applicable for Group C requirements.)
        - In addition, substituted compliance will be available where the swap dealer's counterparty is neither a U.S. person nor a U.S. branch.
    - *Purple:* The Cross-Border Rule provides only limited additional relief to U.S. swap dealers, on the one hand, and to non-U.S. swap dealers that are Guaranteed Entities or SRSs, on the other, when they are operating from branches outside the United States.

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[47] "U.S. branch" means "a branch or agency of a non-U.S. banking organization where such branch or agency: (i) Is located in the United States; (ii) Maintains accounts independently of the home office and other U.S. branches, with the profit or loss accrued at each branch determined as a separate item for each U.S. branch; and (iii) Engages in the business of banking and is subject to substantive banking regulation in the state or district where located."

A "swap booked in a U.S. branch" means "a swap entered into by a U.S. branch where the swap is reflected in the local accounts of the U.S. branch."

That additional relief is available if the swap dealers' counterparties are themselves neither U.S. persons nor Guaranteed Entities or SRSs of a swap dealer. In such circumstances, none of the Group B requirements will apply if two additional conditions are met:

- Substituted compliance is *not* available for the requirement (if substituted compliance is available, then that is the sole alternative to complying with the CFTC's requirements).
- The volume of swap transactions executed in reliance on the exception does not exceed, during any calendar quarter, 5% of the aggregate gross notional amount of all of its swaps, measured (i) in the case of U.S. swap dealer, across all foreign branches, or (ii) in the case of a non-U.S. swap dealer that is a Guaranteed Entity or SRS, together with all other affiliated swap dealers that are Guaranteed Entities or SRSs.

The Adopting Release — but not the text of the Cross-Border Rule — refers to this exception by two defined terms. Those terms differ depending on whether the swap dealer in question is a U.S. swap dealer (conducting swaps through a foreign branch) or a non-U.S. swap dealer that is a Guaranteed Entity or an SRS of a U.S. swap dealer (booking swaps in a branch other than a U.S. branch). In the former case, the Adopting Release (including matrix) refers to the exception as the "Limited Foreign Branch Group B Exception"; in the latter case, the Adopting Release (including matrix) refers to the exception as the "Limited Swap Entity SRS/Guaranteed Entity Group B Exception." The two exceptions are effectively the same, differing only in how the 5% limit is applied (as described above).

- *Red:* In the case of other swap dealers — that is, non-U.S. swap dealers that are Other Non-U.S. Persons (i.e., neither Guaranteed Entities nor SRSs) — a further exception may apply, without the additional (purple) conditions, when the swap dealers book swaps in non-U.S. branches. That exception applies if the swap dealer's counterparty is neither a U.S. person nor a Guaranteed Entity or an SRS of a swap dealer. This exception further underscores the CFTC's determination regarding ANE Transactions: A non-U.S. swap dealer's swap transactions with end users that are non-U.S. persons will not be subject to the Group B requirements if the non-U.S. swap dealer does not book the transaction in a U.S. branch — even when the transactions are arranged, negotiated, and executed on behalf of the non-U.S. swap dealer by personnel in the United States.

Group C Requirements — More Relief, Less Complexity

As noted above, the Group C requirements relate to (i) business conduct standards for swap dealers when dealing with their swap counterparties and (ii) the rights of swap dealers' counterparties to require segregation of initial margin posted to the swap dealers (where segregation is not otherwise required pursuant to the CFTC's rules).

The Cross-Border Rule's approach to the Group C requirements uses defined terms and concepts similar to those used in its approach to the Group B requirements. However, it addresses the Group C requirements more simply: In each case where the Cross-Border Rule provides relief from Group B requirements by permitting substituted compliance, the Cross-Border Rule provides relief from the Group C requirements by simply providing an unconditional exception to those requirements. That outcome is evident in our color-coded version of the Adopting Release's matrix summarizing how Group C requirements will apply on a cross-border basis (below).[48] As in the case of the matrix above, "Yes" means the Group C requirements apply, and "No" means that they do not:

Counterparty → / Swap Entity ↓		U.S. Person		Non-U.S. Person			
		Non-Foreign Branch	Foreign Branch	U.S. Branch	Guaranteed Entity	SRS	Other Non-U.S. Person
U.S. Swap Entity	Non-Foreign Branch	Yes	Yes	Yes	Yes	Yes	Yes
	Foreign Branch	Yes[1]	No	Yes[1]	No	No	No
Non-U.S. Swap Entity	U.S. Branch	Yes	Yes	Yes	Yes	No	No
	Guaranteed Entity or SRS	Yes[1]	No	Yes[1]	No	No	No
	Other Non-U.S. Person	Yes[1]	No	Yes[1]	No	No	No

[1]The Exchange-Traded Exception is available from certain group B and C requirements for certain anonymous, exchange-traded, and cleared foreign-based swaps between the listed parties.

In the Adopting Release, the CFTC explained why it took a more permissive approach to the Group C requirements:

> [J]ust as the Commission has a strong supervisory interest in regulating and enforcing the group C requirements associated with swaps taking place in the United States, foreign regulators would have a similar interest in overseeing sales practices for swaps occurring within their jurisdictions. Further, given the scope of section 2(i) of the CEA with respect to the Commission's regulation of swap activities outside the United States, the Commission stated that it believes imposing its group C requirements on a foreign-based swap between a non-U.S. swap entity or foreign branch of a U.S. swap entity, on one

[48] See Adopting Release, Table D at 56996-97.

hand, and a foreign counterparty, on the other, is generally not necessary to advance the customer protection goals of the Dodd-Frank Act embodied in the group C requirements.[49]

[49] Adopting Release at 56970.

Annex B

Cross-Border Rule Definitions

U.S. Person

"U.S. Person" means

(1) a natural person resident in the United States;

(2) 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;

(3) an account (whether discretionary or nondiscretionary) of a U.S. person; or

(4) an estate of a decedent who was a resident of the United States at the time of death.[1]

Certain international financial institutions are excluded from the definition.

The term "principal place of business" means the location from which the officers, partners, or managers of the legal person primarily direct, control, and coordinate the activities of the legal person.[2] For CIVs in particular, the principal place of business is in the U.S. if the senior personnel responsible for the implementation of the CIV's investment strategy are located in the U.S., depending on the facts and circumstances that are relevant to determining the center of direction, control, and coordination of the CIV.[3]

Guarantee

"Guarantee" means 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.[4]

The definition encompasses the situation where a non-U.S. person's counterparty has recourse to a U.S. person for the performance of the non-U.S. person's obligations under a swap by virtue of the U.S. person's unlimited responsibility for the non-U.S. person (i.e., the unlimited U.S. responsibility prong),[5] as well as situations where the counterparty to the swap has rights of recourse, regardless of the form of arrangement, against at least one U.S. person (individually, jointly, and/or severally with others) for the non-U.S. person's obligations under the swap.[6]

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[1] 17 C.F.R. 23(a)(23).

[2] 17 C.F.R. 23(a)(23)(ii).

[3] Adopting Release at 56932.

[4] 17 C.F.R. 23(a)(9).

[5] See SEC Cross-Border Rule, 79 Fed. Reg. at 47316-17, 47344.

[6] See Adopting Release at 56940.

Significant Risk Subsidiary

SRS is a new category of entity. It means any non-U.S. persons if all of the following apply:

(1) The non-U.S. person is a “significant subsidiary” of an “ultimate U.S. parent entity.”

(2) The “ultimate U.S. parent entity” has more than $50 billion in global consolidated assets, as determined in accordance with U.S. generally accepted accounting principles (GAAP) at the end of the most recently completed fiscal year.

(3) The non-U.S. person is not subject to either (a) consolidated supervision and regulation by the Board of Governors of the Federal Reserve System as a subsidiary of a U.S. bank holding company or an intermediate holding company or (b) capital standards and oversight by the non-U.S. person’s home country supervisor 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 with respect to uncleared swap margin requirements.[7]

The following definitions are also provided in the final rule for purposes of interpreting the SRS definition:

(1) “Subsidiary” means an affiliate of a person controlled by such person directly, or indirectly through one or more intermediates.[8]

(2) “Significant subsidiary” means a subsidiary, including its own subsidiaries, where (1) 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 U.S. parent entity’s consolidated equity capital, as determined in accordance with GAAP at the end of the most recently completed fiscal year (the “equity capital significance test”); (2) 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 U.S. parent entity’s consolidated revenue, as determined in accordance with GAAP at the end of the most recently completed fiscal year (the “revenue significance test”) or (3) the three-year rolling average of the subsidiary’s assets is equal to or greater than 10% of the three-year rolling average of its ultimate U.S. parent entity’s consolidated assets, as determined in accordance with GAAP at the end of the most recently completed fiscal year (the “asset significance test”).[9]

(3) “Affiliate” means a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.[10]

[7] 17 C.F.R. 23(a)(13).

[8] 17 C.F.R. 23(a)(15).

[9] 17 C.F.R. 23(a)(14); Adopting Release at 56944.

[10] 17 C.F.R. 23(a)(1).

(4) “Control” (including controlling, controlled by, and under common control with) 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.[11]

(5) “Parent entity” means any entity in a consolidated group that has one or more subsidiaries in which the entity has a controlling interest, in accordance with GAAP.[12]

(6) “Ultimate U.S. parent entity” means the U.S. parent entity that is not a subsidiary of any other U.S. parent entity.[13]

Swap Entity

The term “swap entity” means a person that is registered with the CFTC as a swap dealer or major swap participant pursuant to the Commodity Exchange Act.[14] A “U.S. swap entity” means a swap entity that is a U.S. person, and “non-U.S. swap entity” means a swap entity that is not a U.S. swap entity.[15] The terms are used in the Cross-Border Rule to distinguish where certain requirements or exemptions from requirements apply to all, or a limited subset of, swap entities.

Foreign Branch (and Swap Conducted Through a Foreign Branch)

The term “foreign branch” means any office of a U.S. bank that (i) is located outside the United States; (ii) operates for valid business reasons; (iii) 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 (iv) is engaged in the business of banking and is subject to substantive regulation in banking or financing in the jurisdiction where it is located.[16] The CFTC stated that the requirement that the foreign branch be located outside of the United States is consistent with its stated goal of identifying certain swap activity that is not conducted within the United States. The CFTC further stated that the requirements that the foreign branch maintain accounts independent of the U.S. entity, operate for valid business reasons, and be engaged in the business of banking or finance and be subject to substantive banking or financing regulation in its non-U.S. jurisdiction will prevent an entity from setting up shell operations outside the United States.[17]

A “swap conducted through a foreign branch” means a swap entered into by a foreign branch where (i) the foreign branch or another foreign branch is the office through which the U.S. 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 U.S. person is such foreign branch; (ii) the swap is entered into by such foreign branch in its normal course of business; and (iii) the

[11] 17 C.F.R. 23(a)(2).

[12] 17 C.F.R. 23(a)(12).

[13] 17 C.F.R. 23(a)(19).

[14] 17 C.F.R. 23(a)(18).

[15] 17 C.F.R. 23(a)(11), (24).

[16] 17 C.F.R. 23(a)(3).

[17] See Adopting Release at 56948.

swap is reflected in the local accounts of the foreign branch.[18] The definition identifies the type of swap activity for which the foreign branch performs key dealing functions outside the United States. Because a foreign branch of a U.S. bank is not a separate legal entity, the first prong of the definition clarifies that the foreign branch must be the office of the U.S. bank through which payments and deliveries under the swap are made.[19] The second prong of the definition is intended as an antievasion measure to prevent a U.S. bank from routing swaps for booking in a foreign branch so that the swap would be treated as a swap conducted through a foreign branch registration threshold purposes or for purposes of certain regulatory requirements.[20] With respect to the third prong, where a swap is with the foreign branch of a U.S. bank, it generally would be reflected in the foreign branch's accounts.[21]

U.S. Branch (and Swap Booked in a U.S. Branch)

The term "U.S. branch" means a branch or agency of a non-U.S. banking organization where such branch or agency (i) is located in the United States; (ii) maintains accounts independently of the home office and other U.S. branches, with the profit or loss accrued at each branch determined as a separate item for each U.S. branch; and (iii) engages in the business of banking and is subject to substantive banking regulation in the state or district where located.[22]

A "swap booked in a U.S. branch" means a swap entered into by a U.S. branch where the swap is reflected in the local accounts of the U.S. branch.[23]

Foreign-Based Swap

The term "foreign-based swap" means (i) a swap by a non-U.S. swap entity, except for a swap booked in a U.S. branch, or (ii) a swap conducted through a foreign branch.[24]

Foreign Counterparty

The term "foreign counterparty" means (i) a non-U.S. person, except with respect to a swap booked in a U.S. branch of that non-U.S. person, or (ii) a foreign branch where it enters into a swap in a manner that satisfies the definition of a swap conducted through a foreign branch.[25]

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[18] 17 C.F.R. § 23.23(a)(17).

[19] Adopting Release at 56948.

[20] Adopting Release at 56948.

[21] Adopting Release at 56949.

[22] 17 C.F.R. § 23.23(a)(21).

[23] 17 C.F.R. § 23.23(a)(16).

[24] 17 C.F.R. § 23.23(a)(4).

[25] 17 C.F.R. § 23.23(a)(5).

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